S. Hrg. 99-689

NATURAL GAS LEGISLATION

HEARING

BEFORE THE

SUBCOMMITTEE ON
ENERGY REGULATION AND CONSERVATION

OF THE

COMMITTEE ON
ENERGY AND NATURAL RESOURCES
UNITED STATES SENATE

NINETY-NINTH CONGRESS

SECOND SESSION

S. 1251

ENTITLED THE "NATURAL GAS UTILIZATION ACT OF 1985"

S. 1302

TO AMEND THE NATURAL GAS POLICY ACT OF 1978, TO PROTECT CONSUMERS FROM MARKET DISTORTIONS THAT OCCUR AS A CONSEQUENCE OF CURRENT PARTIAL REGULATION OF NATURAL GAS PRICES BY ELIMINATING THE REMAINING WELLHEAD PRICE REGULATION AS CONTRACTS EXPIRE, OR TERMINATE, OR ARE RENEGOTIATED, TO PERMIT NATURAL GAS CONTRACTS TO REFLECT FREE MARKET PRICES, TO ELIMINATE INCREMENTAL PRICING REQUIREMENTS FOR NATURAL GAS, TO ELIMINATE CERTAIN RESTRICTIONS ON THE USE OF NATURAL GAS AND PETROLEUM, AND FOR OTHER PURPOSES

S. 2205

TO ELIMINATE CERTAIN RESTRICTIONS ON THE USE OF NATURAL GAS AND PETROLEUM, AND FOR OTHER PURPOSES

S. 2285

TO PROMOTE COMPETITION IN THE NATURAL GAS MARKET, TO ENSURE OPEN ACCESS TO TRANSPORTATION SERVICE, TO ENCOURAGE PRODUCTION OF NATURAL GAS, TO PROVIDE NATURAL GAS CONSUMERS WITH ADEQUATE SUPPLIES AT REASONABLE PRICES, TO ELIMINATE DEMAND RESTRAINTS, AND FOR OTHER PURPOSES

APRIL 15, 1986

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NATURAL GAS LEGISLATION

TUESDAY, APRIL 15, 1986

U.S. Senate,
Subcommittee on Energy
Regulation and Conservation,
Committee on Energy and Natural Resources,
Washington, DC.

The subcommittee met, pursuant to notice, at 10 a.m., in room SD-366, Dirksen Senate Office Building, Hon. Don Nickles presiding.

Present: Senators Nickles, Domenici, Warner, Ford, Metzenbaum, and Bingaman.

Also present: Howard Useem, professional staff member; and Elizabeth Moler, counsel for the minority.

OPENING STATEMENT OF HON. DON NICKLES, A U.S. SENATOR FROM THE STATE OF OKLAHOMA

Senator Nickles. Good morning. The focus of the hearing today is very straightforward. The Federal Government should get out of the natural gas business. Its involvement since 1983 has disrupted the market, created artificial shortages, increased consumer prices and hurt domestic producers. The most productive action Congress could now take is a total deregulation of all natural gas and the repeal of all end-use restraints.

It is no news to anyone today that the energy-producing States, like Oklahoma, are suffering because of the depression in the energy industry. There are some things the Government can do to help

In this Senator's opinion, one would be to tax imports as much as the domestics producers have had to pay in the windfall profits tax. We should also repeal the windfall profits tax. Another is the total deregulation of natural gas and the repeal of the Fuel Use Act and incremental pricing.

Today, we are focusing strictly on natural gas. We need to get the Government out of the natural gas business. Natural gas industry is the only domestic natural resource still controlled by the Federal Government. In my State of Oklahoma, we have natural gas that we can't sell because of ridiculous Government regulations. Some of that gas today is selling for as little as $1.40 and still we have gas that is shut in throughout our State and the producing States because of laws such as the Fuel Use Act which prohibits the use of natural gas in new utilities.

That makes no sense. Last year, the wellhead price of natural gas fell about 11 percent. When data becomes available for this year, I think we will also see a continued and further price deline. With these declining prices and with it really being a buyer's market, I think we do have an opportunity to make some changes—long-time, needed changes—in the natural gas industry.

Looking back a little in Oklahoma history, I see where Senator Kirk was fighting the same battle in the early 1950's, to repeal natural gas, or to decontrol natural gas legislation. We have been fighting this battle for a long time and I think 1986 is the year that we should succeed.

With this in mind, S. 1302, which I have introduced, S. 2285, the administration's bill, a more comprehensive bill dealing with a full range of problems in the natural gas industry. Also, we have S. 2205, which I have introduced and S. 1251, by Senators Domenici and Johnston, which are seeking to make changes in incremental pricing in the Fuel Use Act, as well.

As chairman of this subcommittee and someone who has been initimately involved in the natural gas problems, and the energy problems, I am fully committed to doing something this year, positive, toward natural gas decontrol. I think we do have an opportunity. I don't think we should waste it.

I am pleased that we have joining us today several witnesses who are experts in this area. I hope that we will be able to afford all of our witnesses adequate time to present their views.

I am particularly proud that we have Secretary Herrington, Secretary of Energy, join us today. I look forward to your comments, and also examining your legislation that you have proposed, to see what elements we have in common and what elements of that that we might be able to move forward, pass and have signed by the President this year.

[The texts of S. 1251, S. 1302, S. 2205, and S. 2285 follow:]

II

99TH CONGRESS
1ST SESSION

S. 1251

Entitled the "Natural Gas Utilization Act of 1985".

IN THE SENATE OF THE UNITED STATES

JUNE 6 (legislative day, JUNE 3), 1985

Mr. DOMENICI (for himself and Mr. JOHNSTON) introduced the following bill; which was read twice and referred to the Committee on Energy and Natural Resources

---

A BILL

Entitled the "Natural Gas Utilization Act of 1985".

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. (a) SHORT TITLE.—This Act may be cited as the "Natural Gas Utilization Act of 1985".

(b) TABLE OF CONTENTS.—

TABLE OF CONTENTS

Sec. 1. Short title; table of contents.
Sec. 101. Repeal of certain sections of the Powerplant and Industrial Fuel Use Act of 1978.
Sec. 102. Conforming amendments.
Sec. 103. Repeal of incremental pricing requirements.
Sec. 104. Effective date.

REPEAL OF CERTAIN SECTIONS OF THE POWERPLANT AND INDUSTRIAL FUEL USE ACT OF 1978

SEC. 101. (a) The following sections of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8301 et seq.) are repealed:

(1) sections 103 (a)(16), (a)(18), (a)(19), and (a)(29)—(42 U.S.C. 8302 (a)(16), (a)(18), (a)(19), and (a)(29));

(2) sections 201 and 202 (42 U.S.C. 8311 and 8312);

(3) section 302 (42 U.S.C. 8342);

(4) section 401 (42 U.S.C. 8371);

(5) section 402 (42 U.S.C. 8372); and

(6) section 405 (42 U.S.C. 8375).

(b) The table of contents of the Powerplant and Industrial Fuel Use Act of 1978 is amended by striking the items relating to the sections repealed by subsection (a) of this section.

CONFORMING AMENDMENTS

SEC. 102. (a) Section 102 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8301) is amended by striking "and major fuel-burning installations" and "and new" wherever these phrases appear.

(b) Section 103 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8302) is amended—

(1) in subsection (a)(13)(B), by—.

(A) striking clause (ii)(III);

(B) striking "; or" at the end of clause (ii)(II), and inserting a period in its place; and

(1) in subsection (c), "new or" in the phrase "applicable to any new or existing electric powerplant"; and

(2) subsection (g).

(g) Section 701 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8411) is amended by striking—

(1) in the last sentence of subsection (b), "or installation";

(2) subsection (c);

(3) in the title of subsection (d), "And Exemptions";

(4) in the first sentence of subsection (d)(1), "or any petition for any order granting an exemption (or permit";

(5) in subsection (d)(1)(B), "or in the consideration of such petition,";

(6) in subsection (f), "or a petition for an exemption (or permit) under this Act (other than under section 402 or 404),"; and

(7) subsection (g).

(h) Section 702 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8412) is amended by striking—

(1) in the title of subsection (a), "Or Exemption";

(2) in subsection (a), "or granting an exemption (or permit)";

(3) subsection (b), and redesignating subsection (c) as subsection (b);

(4) in the first sentence of subsection (b)(1) (as redesignated), "or by the denial of a petition for an order granting an exemption (or permit) referred to in subsection (b),";

(5) in the first sentence of subsection (b)(1) (as redesignated), "such rule, order, or denial is published under subsection (a) or (b)" and inserting in its place "such rule, or order is published under subsection (a)";

(6) in the first sentence of subsection (b)(2) (as redesignated), "the rule, order, or denial" and inserting in its place "the rule or order";

(7) in the second sentence of subsection (b)(2) (as redesignated), "(or denial thereof)"; and

(8) in subsection (b)(3) (as redesignated), "any such rule, order, or denial" and inserting in its place "any such rule or order".

(i) Section 711 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8421) is amended by striking in the first sentence of subsection (a), "or a major fuel-burning installation".

(j) Section 721 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8431) is amended by striking subsection (c) and redesignating subsection (d) as subsection (c).

(k) Section 723 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8433) is amended by striking subsection (b) and redesignating subsections (c) and (d) as subsections (b) and (c).

(l) Section 731 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8441) is amended by striking—

(C) inserting "and" at the end of clause (ii)(I);

(2) in subsection (a)(15), by striking "or major fuel-burning installation" and "or new" wherever these phrases appear;

(3) in subsection (a)(20), by striking "or major fuel-burning installation";

(4) by redesignating subsections (a)(17), (a)(20), (a)(21), (a)(22), (a)(23), (a)(24), (a)(25), (a)(26), (a)(27), and (a)(28) as subsections (a)(16), (a)(17), (a)(18), (a)(19), (a)(20), (a)(21), (a)(22), (a)(23), (a)(24), and (a)(25);

(5) in subsection (b), by striking "or major fuel-burning installation" wherever this phrase appears;

(6) in subsection (b)(1)(D), by striking everything after "synthetic gas involved" and inserting in its place a period; and

(7) by striking subsection (b)(3), and redesignating subsection (b)(4) as subsection (b)(3).

(c) Section 104 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8303) is amended to read as follows:

"The provisions of the Act shall apply in all the States, Puerto Rico, and the territories and possessions of the United States, except Hawaii and Alaska.".

(d) Section 303 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8343) is amended—

(1) by striking "or installation" and "or installations" wherever the phrases appear;

(2) by striking "or 302" wherever the phrase appears;

(3) by striking subsection (a)(3);

(4) by amending subsection (b)(1) to read as follows:

"(1) The Secretary may prohibit, by rule, the use of natural gas or petroleum under section 301(b) in existing electric powerplants.";

(5) in subsection (b)(3), by striking "or major fuel-burning installation"; and

(6) by amending the last sentence of subsection (b)(3) to read as follows: "Any such rules shall not apply in the case of any existing electric powerplant with respect to which a comparable prohibition was issued by order.".

(e) Section 403 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8373) is amended by striking—

(1) in subsection (a)(1), "major fuel-burning installation, or other unit" and the comma immediately preceding this phrase and "installation, or unit" and the comma immediately preceding this phrase;

(2) in subsection (a)(2), "installation, or other unit" and the comma immediately preceding that phrase, and "installation, or unit" and the comma immediately preceding that phrase;

(3) in subsection (a)(2), the last sentence; and

(4) subsection (a)(3).

(f) Section 404 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8374) is amended by striking—

(1) "or major fuel-burning installation" wherever the phrase appears; and

(2) "title II or" in subsections (a)(1) and (g)(3).

(m) Section 745 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8455) is amended by striking in the first sentence of subsection (a), "from new and existing electric powerplants and major fuel-burning installations" and inserting in its place "from existing electric powerplants".

(n) Section 761 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8471) is amended by striking—

(1) in subsection (a), "any existing or new electric powerplant or major fuel-burning installation" and inserting in its place "any existing electric powerplant"; and

(2) in subsection (b)—

(A) "new or" in the phrase "In the case of any new or existing facility"; and

(B) "except to the extent provided under section 212(b) or section 312(b)" and the comma immediately preceding that phrase.

REPEAL OF INCREMENTAL PRICING REQUIREMENTS

SEC. 103. (a) Subject to subsections (b) and (c) of this section, title II of the Natural Gas Policy Act of 1978 (15 U.S.C. 3341–3348) is repealed, and the items relating to title II are stricken from the table of contents of that Act.

(b) A rule promulgated by the Commission under title II of the Natural Gas Policy Act of 1978 shall continue in effect only with respect to the flowthrough of costs incurred before the enactment of this section, including any surcharges based on such costs.

(c) The Commission may take appropriate action to implement this section.

EFFECTIVE DATE

SEC. 104. The provisions of this Act shall take effect on the date of enactment.

II

99TH CONGRESS
1ST SESSION

S. 1302

To amend the Natural Gas Policy Act of 1978, to protect consumers from market distortions that occur as a consequence of current partial regulation of natural gas prices by eliminating the remaining wellhead price regulation as contracts expire, or terminate, or are renegotiated, to permit natural gas contracts to reflect free market prices, to eliminate incremental pricing requirements for natural gas, to eliminate certain restrictions on the use of natural gas and petroleum, and for other purposes.

IN THE SENATE OF THE UNITED STATES

JUNE 13 (legislative day, JUNE 3), 1985

Mr. NICKLES introduced the following bill; which was read twice and referred to the Committee on Energy and Natural Resources

---

A BILL

To amend the Natural Gas Policy Act of 1978, to protect consumers from market distortions that occur as a consequence of current partial regulation of natural gas prices by eliminating the remaining wellhead price regulation as contracts expire, or terminate, or are renegotiated, to permit natural gas contracts to reflect free market prices, to eliminate incremental pricing requirements for natural gas, to eliminate certain restrictions on the use of natural gas and petroleum, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SHORT TITLE; TABLE OF CONTENTS

SECTION 1. SHORT TITLE.—This act may be cited as the "Natural Gas Regulatory Reform Act of 1985".

TABLE OF CONTENTS

Sec. 1. Short title, table of contents.

TITLE I—REMOVAL OF WELLHEAD PRICE CONTROLS AND REPEAL OF NATURAL GAS ACT JURISDICTION OVER CERTAIN FIRST SALES

Sec. 101. Removal of wellhead price controls.
Sec. 102. Repeal of Natural Gas Act jurisdiction over certain sales of committed or dedicated natural gas.
Sec. 103. Repeal of provisions allowing reimposition of price controls and report to the Congress.

TITLE II—REPEAL OF CERTAIN RESTRICTIONS OF NATURAL GAS AND PETROLEUM USE

Sec. 201. Repeal of certain sections of the Powerplant and Industrial Fuel Use Act of 1978.
Sec. 202. Amendment of certain sections of the Powerplant and Industrial Fuel Use Act of 1978.

TITLE III—REPEAL OF INCREMENTAL PRICING REQUIREMENTS

Sec. 301. Repeal of incremental pricing requirements.

TITLE IV—SEPARABILITY

Sec. 401. Separability.

TITLE I—REMOVAL OF WELLHEAD PRICE CONTROLS AND REPEAL OF NATURAL GAS ACT JURISDICTION OVER CERTAIN FIRST SALES OF NATURAL GAS

REMOVAL OF WELLHEAD PRICE CONTROLS

SEC. 101. Section 121 of the Natural Gas Policy Act of 1978 (15 U.S.C. 3331) is amended by the deletion of the words "Subject to the reimposition of price controls as provided in section 122, the" and inserting in lieu thereof

"The", and by the addition of a new subsection (f) to read as follows:

"(f) SPECIAL RULE.—The provisions of subtitle A shall not apply to—

"(1) gas subject to any contract for the first sale of natural gas that was executed after the date of enactment of this subsection,

"(2) gas subject to any contract for the first sale of natural gas that was renegotiated after the date of enactment of this subsection is such renegotiated contract expressly provides that the provisions of subtitle A shall not apply,

"(3) gas subject to any contract for the first sale of natural gas that will expire, lapse, or terminate pursuant to its own terms after the date of enactment of this subsection at such time as that contract expires, lapses, or terminates pursuant to its own terms,

"(4) gas subject to any contract for the first sale of natural gas that expired, lapsed, or terminated pursuant to its own terms, or

"(5) gas subject to any contract for the first sale of natural gas which does not expire by its own terms and which contains a renegotiation provision, or which is a successor to a contract which contained a renegotiation provision, shall be deemed eligible for renegotiation pursuant to such provision, and any otherwise applicable limitation of the Natural Gas Act or this Act shall not apply.".

REPEAL OF NATURAL GAS ACT JURISDICTION OVER CERTAIN SALES OF COMMITTED OR DEDICATED NATURAL GAS

SEC. 102. Section 601(a)(1)(B) of the Natural Gas Policy Act of 1978 (15 U.S.C. 3431(a)(1)(B)) is amended by striking "or" at the end of clause (ii), by replacing the period at the end of clause (iii) with a semicolon, and by the addition of a new clause (iv) to read as follows:

> "(iv) natural gas exempted from the operation of subtitle A of title I pursuant to section 121(f).".

REPEAL OF PROVISIONS ALLOWING REIMPOSITION OF PRICE CONTROLS AND REPORT TO THE CONGRESS

SEC. 103. (a) Sections 122 and 507 of the Natural Gas Policy Act of 1978 (15 U.S.C. 3332 and 3417) are repealed.

(b) The table of contents of the Natural Gas Policy Act of 1978 (15 U.S.C. 3301 note) is amended by striking the items relating to sections 122 and 507.

TITLE II—REPEAL OF CERTAIN RESTRICTIONS ON THE USE OF NATURAL GAS AND PETROLEUM

SEC. 201. (a) The following sections of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8301 et seq.) are repealed—

(1) sections 103 (a)(16), (a)(18), (a)(19), and (a)(29) (42 U.S.C. 8302 (a)(16), (a)(18), (a)(19), and (a)(29));

(2) sections 201 and 202 (42 U.S.C. 8311 and 8312);

(3) section 302 (42 U.S.C. 8342);

(4) section 401 (42 U.S.C. 8371);

(5) section 402 (42 U.S.C. 8372); and

(6) section 405 (42 U.S.C. 8375).

(b) The table of contents of the Powerplant and Industrial Fuel Use Act of 1978 is amended by striking the items relating to the sections repealed by subsection (a) of this section.

SEC. 202. (a) Section 102 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8301) is amended by striking "and major fuel-burning installations" and "and new" wherever these phrases appear.

(b) Section 103 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8302) is amended—

(1) in subsection (a)(13)(B), by—

(A) striking clause (ii)(III);

(B) striking "; or" at the end of clause (ii)(II), and inserting a period in its place; and

(C) inserting "and" at the end of clause (ii)(I);

(2) in subsection (a)(15), by striking "or major fuel-burning installation" and "or new" wherever these phrases appear;

(3) in subsection (a)(20), by striking "or major fuel-burning installation";

(4) by redesignating subsections (a)(17), (a)(20), (a)(21), (a)(22), (a)(23), (a)(24), (a)(25), (a)(26), (a)(27), and (a)(28) as subsections (a)(16), (a)(17), (a)(18), (a)(19), (a)(20), (a)(21), (a)(22), (a)(23), (a)(24), and (a)(25);

(5) in subsection (b), by striking "or major fuel-burning installation" wherever this phrase appears;

(6) in subsection (b)(1)(D), by striking everything after "synthetic gas involved" and inserting in its place a period; and

(7) by striking subsection (b)(3), and redesignating subsection (b)(4) as subsection (b)(3).

(c) Section 104 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8303) is amended to read as follows:

"The provisions of the Act shall apply in all the States, Puerto Rico, and the territories and possessions of the United States, except Hawaii and Alaska.".

(d) Section 303 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8343) is amended—

(1) by striking "or installation" and "or installations" wherever the phrases appear;

(2) by striking "or 302" wherever the phrase appears;

(3) by striking subsection (a)(3);

(4) by amending subsection (b)(1) to read as follows:

"(1) The Secretary may prohibit, by rule, the use of natural gas or petroleum under section 301(b) in existing electric powerplants.";

(5) in subsection (b)(3), by striking "or major fuel-burning installation"; and

(6) by amending the last sentence of subsection (b)(3) to read as follows: "Any such rules shall not apply in the case of any existing electric powerplant with respect to which a comparable prohibition was issued by order.".

(e) Section 403 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8373) is amended by striking—

(1) in subsection (a)(1), "major fuel-burning installation, or other unit" and the comma immediately preceding this phrase and "installation, or unit" and the comma immediately preceding this phrase;

(2) in subsection (a)(2), "installation, or other unit" and the comma immediately preceding that phrase, and "installation, or unit" and the comma immediately preceding that phrase;

(3) in subsection (a)(2), the last sentence; and

(4) subsection (a)(3).

(f) Section 404 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8374) is amended by striking—

(1) in subsection (c), "new or" in the phrase "applicable to any new or existing electric powerplant"; and

(2) subsection (g).

(g) Section 701 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8411) is amended by striking—

(1) in the last sentence of subsection (b), "or installation";

(2) subsection (c);

(3) in the title of subsection (d), "AND EXEMPTIONS";

(4) in the first sentence of subsection (d)(1), "or any petition for any order granting an exemption (or permit)";

(5) in subsection (d)(1)(B), "or in the consideration of such petition";

(6) in subsection (f), "or a petition for an exemption (or permit) under this Act (other than under section 402 or 404),"; and

(7) subsection (g).

(h) Section 702 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8412) is amended by striking—

(1) in the title of subsection (a), "OR EXEMPTION";

(2) in subsection (a), "or granting an exemption (or permit)";

(3) subsection (b), and redesignating subsection (c) as subsection (b);

(4) in the first sentence of subsection (b)(1) (as redesignated), "or by the denial of a petition for an order granting an exemption (or permit) referred to in subsection (b),";

(5) in the first sentence of subsection (b)(1) (as redesignated), "such rule, order, or denial is published under subsection (a) or (b)" and inserting in its place "such rule, or order is published under subsection (a)";

(6) in the first sentence of subsection (b)(2) (as redesignated), "the rule, order, or denial" and inserting in its place "the rule or order";

(7) in the second sentence of subsection (b)(2) (as redesignated), "(or denial thereof)"; and

(8) in subsection (b)(3) (as redesignated), "any such rule, order, or denial" and inserting in its place "any such rule or order".

(i) Section 711 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8421) is amended by striking in the first sentence of subsection (a), "or major fuel-burning installation".

(j) Section 721 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8431) is amended by striking subsection (c) and redesignating subsection (d) as subsection (c).

(k) Section 723 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8433) is amended by striking subsection (b) and redesignating subsections (c) and (d) as subsections (b) and (c).

(l) Section 731 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8441) is amended by striking—

2 (1) "or major fuel-burning installation" wherever the phrase appears; and

(2) "title II or" in subsections (a)(1) and (g)(3).

(m) Section 745 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8455) is amended by striking in the first sentence of subsection (a), "from new and existing electric powerplants and major fuel-burning installations" and inserting in its place "from existing electric powerplants".

(n) Section 761 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8471) is amended by striking—

(1) in subsection (a), "any existing or new electric powerplant or major fuel-burning installation" and inserting in its place "any existing electric powerplant"; and

(2) in subsection (b)—

(A) "new or" in the phrase "In the case of any new or existing facility"; and

(B) "except to the extent provided under section 212(b) or section 312(b)" and the comma immediately preceding that phrase.

TITLE III—REPEAL OF INCREMENTAL PRICING REQUIREMENTS

Sec. 301. (a) Subject to subsections (b) and (c) of this section, title II of the Natural Gas Policy Act of 1978 (15 U.S.C. 3341–3348) is repealed, and the items relating to title II are stricken from the table of contents of that Act.

(b) A rule promulgated by the Commission under title II of the Natural Gas Policy Act of 1978 shall continue in effect only with respect to the flow-through of costs incurred before the enactment of this section, including any surcharges based on such costs.

(c) The Commission may take appropriate action to implement this section.

TITLE IV—SEPERABILITY

Sec. 401. If any provision of this act or its application to any person or circumstance is held invalid, the remainder of the act or the applicability of any other provison to any other person or circumstance shall not be affected.

II

99TH CONGRESS
2D SESSION

S. 2205

To eliminate certain restrictions on the use of natural gas and petroleum, and for other purposes.

IN THE SENATE OF THE UNITED STATES

MARCH 18, 1986

Mr. NICKLES (for himself and Mr. BOREN) introduced the following bill; which was read twice and referred to the Committee on Energy and Natural Resources

---

A BILL

To eliminate certain restrictions on the use of natural gas and petroleum, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SHORT TITLE; TABLE OF CONTENTS

SECTION 1. SHORT TITLE.—This Act may be cited as the "Fuel Use Act Repeal Bill of 1986".

TABLE OF CONTENTS

TITLE I—REPEAL OF CERTAIN RESTRICTIONS OF NATURAL GAS AND PETROLEUM USE

Sec. 101. Repeal of certain sections of the Powerplant and Industrial Fuel Use Act of 1978.
Sec. 102. Amendment of certain sections of the Powerplant and Industrial Fuel Use Act of 1978.

TITLE II—SEPARABILITY

Sec. 201. Separability.

TITLE I—REPEAL OF CERTAIN RESTRICTIONS ON THE USE OF NATURAL GAS AND PETROLEUM

SEC. 101. (a) The following sections of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8301 et seq.) are repealed—

(1) sections 103 (a)(16), (a)(18), (a)(19), and (a)(29) (42 U.S.C. 8302 (a)(16), (a)(18), (a)(19), and (a)(29));

(2) sections 201 and 202 (42 U.S.C. 8311 and 8312);

(3) section 302 (42 U.S.C. 8342);

(4) section 401 (42 U.S.C. 8371);

(5) section 402 (42 U.S.C. 8372); and

(6) section 405 (42 U.S.C. 8375).

(b) The table of contents of the Powerplant and Industrial Fuel Use Act of 1978 is amended by striking the items relating to the sections repealed by subsection (a) of this section.

SEC. 202. (a) Section 102 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8301) is amended by striking "and major fuel-burning installations" and "and new" wherever these phrases appear.

(b) Section 103 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8302) is amended—

(1) in subsection (a)(13)(B), by—

(A) striking clause (ii)(III);

(B) striking "; or" at the end of clause (ii)(II), and inserting a period in its place; and

(C) inserting "and" at the end of clause (ii)(I);

(2) in subsection (a)(15), by striking "or major fuel-burning installation" and "or new" wherever these phrases appear;

(3) in subsection (a)(20), by striking "or major fuel-burning installation";

(4) by redesignating subsections (a)(17), (a)(20), (a)(21), (a)(22), (a)(23), (a)(24), (a)(25), (a)(26), (a)(27), and (a)(28) as subsections (a)(16), (a)(17), (a)(18), (a)(19), (a)(20), (a)(21), (a)(22), (a)(23), (a)(24), and (a)(25);

(5) in subsection (b), by striking "or major fuel-burning installation" wherever this phrase appears;

(6) in subsection (b)(1)(D), by striking everything after "synthetic gas involved" and inserting in its place a period; and

(7) by striking subsection (b)(3), and redesignating subsection (b)(4) as subsection (b)(3).

(c) Section 104 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8303) is amended to read as follows:

"The provisions of the Act shall apply in all the States, Puerto Rico, and the territories and possessions of the United States, except Hawaii and Alaska.".

(d) Section 303 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8343) is amended—

(1) by striking "or installation" and "or installations" wherever the phrases appear;

(2) by striking "or 302" wherever the phrase appears;

(3) by striking subsection (a)(3);

(4) by amending subsection (b)(1) to read as follows:

"(1) The Secretary may prohibit, by rule, the use of natural gas or petroleum under section 301(b) in existing electric powerplants.";

(5) in subsection (b)(3), by striking "or major fuel-burning installation"; and

(6) by amending the last sentence of subsection (b)(3) to read as follows: "Any such rules shall not apply in the case of any existing electric powerplant with respect to which a comparable prohibition was issued by order.".

(e) Section 403 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8373) is amended by striking—

(1) in subsection (a)(1), "major fuel-burning installation, or other unit" and the comma immediately preceding this phrase and "installation, or unit" and the comma immediately preceding this phrase;

(2) in subsection (a)(2), "installation, or other unit" and the comma immediately preceding that phrase, and "installation, or unit" and the comma immediately preceding that phrase;

(3) in subsection (a)(2), the last sentence; and

(4) subsection (a)(3).

(f) Section 404 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8374) is amended by striking—

(1) in subsection (c), "new or" in the phrase "applicable to any new or existing electric powerplant"; and

(2) subsection (g).

(g) Section 701 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8411) is amended by striking—

(1) in the last sentence of subsection (b), "or installation";

(2) subsection (c);

(3) in the title of subsection (d), "AND EXEMPTIONS";

(4) in the first sentence of subsection (d)(1), "or any petition for any order granting an exemption (or permit)";

(5) in subsection (d)(1)(P), "or in the consideration of such petition";

(6) in subsection (f), "or a petition for an exemption (or permit) under this Act (other than under section 402 or 404),"; and

(7) subsection (g).

(h) Section 702 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8412) is amended by striking—

(1) in the title of subsection (a), "OR EXEMPTION";

(2) in subsection (a), "or granting an exemption (or permit)";

(3) subsection (b), and redesignating subsection (c) as subsection (b);

(4) in the first sentence of subsection (b)(1) (as redesignated), "or by the denial of a petition for an order granting an exemption (or permit) referred to in subsection (b),";

(5) in the first sentence of subsection (b)(1) (as redesignated), "such rule, order, or denial is published under subsection (a) or (b)" and inserting in its place "such rule, or order is published under subsection (a)";

(6) in the first sentence of subsection (b)(2) (as redesignated), "the rule, order, or denial" and inserting in its place "the rule or order";

(7) in the second sentence of subsection (b)(2) (as redesignated), "(or denial thereof)"; and

(8) in subsection (b)(3) (as redesignated), "any such rule, order, or denial" and inserting in its place "any such rule or order".

(i) Section 711 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8421) is amended by striking in the first sentence of subsection (a), "or major fuel-burning installation".

(j) Section 721 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8431) is amended by striking subsection (c) and redesignating subsection (d) as subsection (c).

(k) Section 723 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8433) is amended by striking subsection (b) and redesignating subsections (c) and (d) as subsections (b) and (c).

Section 731 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8441) is amended by striking—

(1) "or major fuel-burning installation" wherever the phrase appears; and

(2) "title II or" in subsections (a)(1) and (g)(3).

(m) Section 745 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8455) is amended by striking in the first sentence of subsection (a), "from new and existing electric powerplants and major fuel-burning installations" and inserting in its place "from existing electric powerplants".

(n) Section 761 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8471) is amended by striking—

(1) in subsection (a), "any existing of new electric powerplant or major fuel-burning installation" and inserting in its place "any existing electric powerplant"; and

(2) in subsection (b)—

(A) "new or" in the phrase "In the case of any new or existing facility"; and

(B) "except to the extent provided under section 212(b) or section 312(b)" and the comma immediately preceding that phrase.

TITLE II—SEPARABILITY

SEC. 201. If any provision of this act or its application to any person or circumstance is held invalid, the remainder of the act or the applicability of any other provision to any other person or circumstance shall not be affected.

II

99TH CONGRESS
2D SESSION

S. 2285

To promote competition in the natural gas market, to ensure open access to transportation service, to encourage production of natural gas, to provide natural gas consumers with adequate supplies at reasonable prices, to eliminate demand restraints, and for other purposes.

IN THE SENATE OF THE UNITED STATES

APRIL 10 (legislative day, April 8), 1986

Mr. MCCLURE (by request) introduced the following bill; which was read twice and referred to the Committee on Energy and Natural Resources

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A BILL

To promote competition in the natural gas market, to ensure open access to transportation service, to encourage production of natural gas, to provide natural gas consumers with adequate supplies at reasonable prices, to eliminate demand restraints, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Natural Gas Policy Act Amendments of 1986".

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TITLE I—OPEN ACCESS TO TRANSPORTATION

Sec. 101. Nondiscriminatory authorizations.
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TITLE II—REMOVAL OF WELLHEAD PRICE CONTROLS AND REPEAL OF JURISDICTION OVER FIRST SALES

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Sec. 203. Effect of area rate clauses.

TITLE III—REPEAL OF CERTAIN RESTRICTIONS ON NATURAL GAS AND PETROLEUM USE AND PRICING

Sec. 301. Repeal of certain sections of the Powerplant and Industrial Fuel Use Act of 1978.
Sec. 302. Conforming amendments.
Sec. 303. Repeal of incremental pricing requirements.

TITLE I—OPEN ACCESS TO TRANSPORTATION

NONDISCRIMINATORY AUTHORIZATIONS

SEC. 101. Section 311(a) of the Natural Gas Policy Act of 1978 (15 U.S.C. 3371(a)) is amended by—

(a) revising paragraph (1) to read as follows:

"(1) IN GENERAL.—The Commission, by rule or order, may authorize any pipeline to transport natural gas on behalf of any person.".

(b) redesignating subparagraph (1)(B) as paragraph (2);

(c) deleting subparagraph (2)(A);

(d) redesignating subparagraphs (2)(B)(i), (2)(B)(ii), (2)(B)(ii)(I), and (2)(B)(ii)(II) as subparagraphs (3)(A), (3)(B), (3)(B)(i), and (3)(B)(ii), respectively.

(e) adding a new paragraph (4) to read as follows:

"(4) NONDISCRIMINATION.—

"(A) A pipeline transporting gas pursuant to this subsection shall do so without discrimination.

"(B) A pipeline receiving gas pursuant to this subsection shall provide transportation service pursuant to this subsection without discrimination.".

OPEN ACCESS CARRIAGE

SEC. 102. (a) Title III of the Natural Gas Policy Act of 1978 (15 U.S.C. 3361–3375) is amended by adding the following new section:

"SEC. 316. OPEN ACESS CARRIAGE.

"Upon request by any person, the Commission shall direct an interstate pipeline to provide transportation service, unless the pipeline demonstrates to the Commission it is incapable of rendering the service. The pipeline shall provide this transportation service without discrimination. The rates and charges for this transportation service shall be just and reasonable within the meaning of the Natural Gas Act. The Commission may implement this section by rule or order, and may attach appropriate terms and conditions consistent with the fullest practicable use of capacity.".

(b) The table of contents of the Natural Gas Policy Act of 1978 (15 U.S.C. 3301 note) is amended by adding after the item relating to section 315 the following:

"Sec. 316. Open access carriage.".

TITLE II—REMOVAL OF WELLHEAD PRICE CONTROLS AND REPEAL OF JURISDICTION OVER FIRST SALES

REMOVAL OF WELLHEAD PRICE CONTROLS

SEC. 201. Section 121 of the Natural Gas Policy Act of 1978 (15 U.S.C. 3331) is amended by adding at its end the following new subsections:

"(f) SPECIAL RULE FOR CERTAIN GAS.—The provisions of subtitle A shall not apply to—

"(1) gas subject to any contract for the first sale of natural gas executed after March 1, 1986, or

"(2) gas subject to any contract for the first sale of natural gas renegotiated after March 1, 1986, if the renegotiated contract expressly provides the provisions of subtitle A shall not apply.

"(g) REMOVAL OF WELLHEAD PRICE CONTROLS ON NATURAL GAS.—Beginning April 1, 1987, the provisions of subtitle A respecting maximum lawful price shall cease to apply to the first sale of any natural gas.".

REPEAL OF COMMISSION JURISDICTION OVER FIRST SALES OF NATURAL GAS

SEC. 202. (a) Section 601(a)(1)(B) of the Natural Gas Policy Act of 1978 (15 U.S.C. 3431(a)(1)(B)) is revised to read as follows:

"(B) COMMITTED OR DEDICATED NATURAL GAS.—For purposes of section 1(b) of the Natural

Gas Act, the provisions of the Natural Gas Act and the jurisdiction of the Commission under such Act shall not apply to natural gas which was committed or dedicated to interstate commerce as of the day before the date of enactment of this Act solely by reason of any first sale of such natural gas.".

(b) Section 315 of the Natural Gas Policy Act of 1978 (15 U.S.C. 3375) is repealed, and the item relating to section 315 is stricken from the table of contents of that Act.

EFFECT OF AREA RATE CLAUSES

SEC. 203. (a) Title III of the Natural Gas Policy Act of 1978 (15 U.S.C. 3361–3375) is amended by adding the following new section:

"SEC. 315. EFFECT OF AREA RATE CLAUSES.—With respect to gas that would be subject to a maximum lawful price under section 104 or 106(a) of this Act except for section 121(g), the last price paid for the gas while it was subject to a maximum lawful price under section 104 or 106(a) shall be considered a federally established rate or price for purposes of an area rate clause. This section shall apply only to a contract that has no indefinite price escalator clause, other than an area rate clause, and that was executed at a time when the inclusion of any indefinite price escalator clause other than an area rate clause was proscribed by Federal regulation.".

(b) The table of contents of the Natural Gas Policy Act of 1978 (15 U.S.C. 3301 note) is amended by adding after the item relating to section 314 the following:

"Sec. 315. Effect of Area Rate Clauses.".

TITLE III—REPEAL OF CERTAIN RESTRICTIONS ON NATURAL GAS AND PETROLEUM USE AND PRICING

REPEAL OF CERTAIN SECTIONS OF THE POWERPLANT AND INDUSTRIAL FUEL USE ACT OF 1978

SEC. 301. (a) The following sections of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8301 et seq.) are repealed:

(1) sections 103(a)(16), (a)(18), (a)(19), and (a)(29) (42 U.S.C. 8302(a)(16), (a)(18), (a)(19), and (a)(29));

(2) sections 201 and 202 (42 U.S.C. 8311 and 8312);

(3) section 302 (42 U.S.C. 8342);

(4) section 401 (42 U.S.C. 8371);

(5) section 402 (42 U.S.C. 8372); and

(6) section 405 (42 U.S.C. 8375).

(b) The table of contents in section 101(b) of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8301(b)) is amended by striking the items relating to the sections repealed by subsection (a) of this section.

CONFORMING AMENDMENTS

SEC. 302. (a) Section 102 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8301) is amended by striking "and major fuel-burning installations" and "and new" wherever these phrases appear.

(b) Section 103 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8302) is amended—

(1) in subsection (a)(13)(B), by—

(A) striking clause (ii)(III);

(B) striking "; or" at the end of clause (ii)(II), and inserting a period in its place; and

(C) inserting "and" at the end of clause (ii)(I);

(2) in subsection (a)(15), by striking "or major fuel-burning installation" and "or new" wherever these phrases appear;

(3) in subsection (a)(20), by striking "or major fuel-burning installation";

(4) by redesignating subsections (a)(17), (a)(20), (a)(21), (a)(22), (a)(23), (a)(24), (a)(25), (a)(26), (a)(27), and (a)(28) as subsections (a)(16), (a)(17), (a)(18), (a)(19), (a)(20), (a)(21), (a)(22), (a)(23), (a)(24), and (a)(25);

(5) in subsection (b), by striking "or major fuel-burning installation" wherever this phrase appears;

(6) in subsection (b)(1)(D), by striking everything after "synthetic gas involved" and inserting in its place a period; and

(7) by striking subsection (b)(3), and redesignating subsection (b)(4) as subsection (b)(3).

(c) Section 104 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8303) is amended to read as follows: "The provisions of this Act shall apply in all the States, Puerto Rico, and the territories and possessions of the United States."

(d) Section 303 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8343) is amended—

(1) by striking "or installation" and "or installations" wherever the phrases appear;

(2) by striking "or 302" wherever the phrase appears;

(3) by striking subsection (a)(3);

(4) by amending subsection (b)(1) to read as follows:

"(1) The Secretary may prohibit, by rule, the use of natural gas or petroleum under section 301(b) in existing electric powerplants.";

(5) in subsection (b)(3), by striking "or major fuel-burning installation"; and

(6) by amending the last sentence of subsection (b)(3) to read as follows: "Any such rules shall not apply in the case of any existing electric powerplant with respect to which a comparable prohibition was issued by order.".

(e) Section 403 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8373) is amended by striking—

(1) in subsection (a)(1), "major fuel-burning installation, or other unit" and the comma immediately preceding this phrase and "installation, or unit" and the comma immediately preceding this phrase;

(2) in subsection (a)(2), "installation, or other unit" and the comma immediately preceding that phrase, and "installation, or unit" and the comma immediately preceding that phrase;

(3) in subsection (a)(2), the last sentence; and

(4) subsection (a)(3).

(f) Section 404 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8374) is amended by striking—

(1) in subsection (c), "new or" in the phrase "applicable to any new or existing electric powerplant"; and

(2) subsection (g).

(g) Section 701 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8411) is amended by striking—

(1) in the last sentence of subsection (b), "or installation";

(2) subsection (c);

(3) in the title of subsection (d), "AND EXEMPTIONS";

(4) in the first sentence of subsection (d)(1), "or any petition for any order granting an exemption (or permit)";

(5) in subsection (d)(1)(B), "or in the consideration of such petition";

(6) in subsection (f), "or a petition for an exemption (or permit) under this Act (other than under section 402 or 404),"; and

(7) subsection (g).

(h) Section 702 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8412) is amended by striking—

(1) in the title of subsection (a), "OR EXEMPTION";

(2) in subsection (a), "or granting an exemption (or permit)";

(3) subsection (b), and redesignating subsection (c) as subsection (b);

(4) in the first sentence of subsection (b)(1) (as redesignated) ", or by the denial of a petition for an

order granting an exemption (or permit) referred to in subsection (b),";

(5) in the first sentence of subsection (b)(1) (as redesignated), "such rule, order, or denial is published under subsection (a) or (b)" and inserting in its place "such rule or order is published under subsection (a)";

(6) in the first sentence of subsection (b)(2) (as redesignated), "the rule, order, or denial" and inserting in its place "the rule or order";

(7) in the second sentence of subsection (b)(2) (as redesignated), "(or denial thereof)"; and

(8) in subsection (b)(3) (as redesignated), "any such rule, order, or denial" and inserting in its place "any such rule or order".

(i) Section 711 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8421) is amended by striking in the first sentence of subsection (a), "or major fuel-burning installation".

(j) Section 721 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8431) is amended by striking subsection (c) and redesignating subsection (d) as subsection (c).

(k) Section 723 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8433) is amended by striking subsection (b) and redesignating subsections (c) and (d) as subsections (b) and (c).

(l) Section 731 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8441) is amended by striking—

(1) "or major fuel-burning installation" wherever the phrase appears; and

(2) "title II or" in subsections (a)(1) and (g)(3).

(m) Section 745 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8455) is amended by striking in the first sentence of subsection (a), "from new and existing electric powerplants and major fuel-burning installations" and inserting in its place "from existing electric powerplants".

(n) Section 761 of the Powerplant and Industrial Fuel Use Act of 1978 (42 U.S.C. 8471) is amended by striking—

(1) in subsection (a), "any existing or new electric powerplant or major fuel-burning installation" and inserting in its place "any existing electric powerplant"; and

(2) in subsection (b)—

(A) "new or" in the phrase "In the case of any new or existing facility"; and

(B) "except to the extent provided under section 212(b) or section 312(b)" and the comma immediately preceding that phrase.

REPEAL OF INCREMENTAL PRICING REQUIREMENTS

SEC. 303. (a) Subject to subsections (b) and (c) of this section, title II of the Natural Gas Policy Act of 1978 (15 U.S.C. 3341–3348) is repealed, and the items relating to title II are stricken from the table of contents of that Act.

(b) A rule promulgated by the Commission under title II of the Natural Gas Policy Act of 1978 shall continue in effect only with respect to the flowthrough of costs incurred before the enactment of the Natural Gas Policy Act Amendments of 1986, including any surcharges based on such costs.

(c) The Commission may take appropriate action to implement this section.

○

Senator NICKLES. Mr. Herrington, welcome, again, to the committee.

STATEMENT OF HON. JOHN S. HERRINGTON, SECRETARY OF ENERGY, ACCOMPANIED BY THEODORE J. GARRISH AND STEPHEN T. MINIHAN

Secretary HERRINGTON. Thank you, very much, Mr. Chairman. It is a great pleasure to be here today to testify on the comprehensive natural gas legislation I transmitted to Congress on behalf of President Reagan last week, the natural gas deregulation bill. I especially appreciate the opportunity to appear because this bill is vital to America's energy future.

I want to offer my written statement for the record and ask that it be submitted, incorporated by reference.

We find ourselves at a critical point in history in the natural gas industry. The benefits of competition have been held in abeyance by outmoded, counterproductive laws and regulations for far too long. As a result, American consumers are paying too much for natural gas and much low-cost gas cannot be brought to the market. The time for reform, as you point out, is clearly now.

I know that you are aware of existing gas market distortions because of your own legislative initiatives. When you addressed them last year, you introduced S. 1302, a bill to decontrol new and renegotiated contracts, and, last month, S. 2205, a bill to eliminate those demand restraints imposed by the Fuel Use Act.

Some of your colleagues in the Senate have also introduced bills aimed at correcting distortions in gas markets. Senator Domenici's S. 1251, introduced last June, would repeal the demand restraints in current law. More recently, Senator Gramm introduced S. 2217. This bill provides for total wellhead decontrol, elimination of demand restraints, and a form of open access carriage.

I want to take this opportunity to express my appreciation for the interest your efforts and those of your colleagues reflect, and to request your continued support in this area.

The reforms proposed by these bills are necessary. We continue to believe, however, the root causes of distortions in current gas markets can be solved only by comprehensive reform legislation that includes the elimination of all remaining wellhead price controls, along with the removal of demand restraints and a strong, open access carriage provision. The President's legislation encompasses all three of these solutions.

It was not long ago that our Nation suffered from severe shortages of natural gas, not because we had run out of gas, but because Federal price controls had discouraged domestic gas producers from finding and developing new gas reserves.

There was much talk during the gas curtailments of the mid-1970's about a crisis in natural gas production. Many believed we had used up our gas resources and couldn't produce enough to keep up with our demand.

Well, there indeed was an energy crisis during the 1970's, but it turned out that, in many ways, the heart of the crisis was not in the gas fields, but on the banks of the Potomac River. The problem wasn't that our energy resources were disappearing or that Americans were using too much energy.

The problem was that our Nation's leaders didn't have faith in competitive forces in the marketplace to solve the problem of energy shortages as quickly as those forces had solved similar problems in the past.

As one of the first acts of his administration, President Reagan decontrolled the price of oil. The results were evident very quickly. Since decontrol, the price of oil has declined dramatically. The Nation took significant steps forward in oil decontrol and partial decontrol of natural gas.

Now we need to finish the job.

Our proposed legislation will accomplish three essential goals. No. 1, it will improve the ability of participants to get gas from the field to the consumer; open transportation is the crux of our effort. No. 2, through total decontrol, it will allow gas to compete in the marketplace. No. 3, it will eliminate artificial restrictions on the use of natural gas.

Our legislation will have three major benefits. No. 1, the American consumers will pay significantly lower prices for the gas supplies. In the first year, after full decontrol, we estimate that the average residential customer will save to $25 to $45 in their gas bills.

For the economy in general, benefits are estimated at between $16 billion and $24 billion over the next 10 years.

No. 2, substantial additional amounts of low-cost old gas will be made available to the consumers. Our analysis indicates that 30 to 34 trillion cubic feet will be produced that would otherwise remain in the ground, and finally, counterproductive market distortions, including the persistent surplus, will be eliminated.

Furthermore, the President's bill will help an indigenous American industry. It will put people to work in our energy industry at a time when we need these new jobs. In return, this will result in increased productivity, less imported oil, and greater economic and energy security.

It was about 3 years ago that this administration first sought full decontrol of natural gas. The Congress at that time was not convinced the weight of the evidence supported comprehensive decontrol.

Today that evidence, in support of comprehensive decontrol is in. We have the experience of partial decontrol behind us and the evidence is compelling. It is clear the benefits of the increased competition and lower prices are not transitory.

Still greater benefits will be realized under the comprehensive decontrol. The facts show that full decontrol would benefit industry, the consumers and the economy of this country. This last point is an important one. No longer should this issue be seen as the producer versus the consumer issue. Regulatory reform benefits everyone.

I urge the Congress to set aside the divisive positions of the past and work together to pass this legislation. I stand ready to work with everyone in Congress to finish the job and I urge you, and your colleagues, to consider our bill carefully and move promptly toward its enactment.

I assure you that President Reagan stands firmly behind this legislative initiatve. I have personally discussed it with him and I take pleasure in forwarding this bill on his behalf. It is one of the highest legislative priorities.

Thank you, Mr. Chairman.

[The prepared statement of Secretary Herrington follows:]

STATEMENT
BY
JOHN S. HERRINGTON
SECRETARY OF ENERGY

BEFORE THE
SUBCOMMITTEE ON ENERGY REGULATION AND CONSERVATION
COMMITTEE ON ENERGY AND NATURAL RESOURCES

UNITED STATES SENATE
APRIL 15, 1986

CHAIRMAN NICKLES, MEMBERS OF THE SUBCOMMITTEE, IT IS A GREAT PLEASURE TO BE HERE TODAY, TO TESTIFY ON THE COMPREHENSIVE NATURAL GAS LEGISLATION I TRANSMITTED TO THE CONGRESS ON BEHALF OF THE PRESIDENT LAST WEEK. I ESPECIALLY APPRECIATE THE OPPORTUNITY TO APPEAR BECAUSE THIS BILL IS VITAL TO AMERICA'S ENERGY FUTURE. MY WRITTEN STATEMENT IS OFFERED FOR THE RECORD.

WE FIND OURSELVES AT A CRITICAL POINT IN THE HISTORY OF THE NATURAL GAS INDUSTRY. THE BENEFITS OF COMPETITION HAVE BEEN HELD IN ABEYANCE BY OUTMODED, COUNTERPRODUCTIVE LAWS AND REGULATIONS FOR FAR TOO LONG. AS A RESULT, AMERICAN CONSUMERS ARE PAYING TOO MUCH FOR NATURAL GAS AND MUCH LOW-COST GAS CANNOT BE BROUGHT TO MARKET. THE TIME FOR REFORM IS CLEARLY NOW.

I KNOW YOU ARE AWARE OF EXISTING GAS MARKET DISTORTIONS BECAUSE OF YOUR OWN LEGISLATIVE INITIATIVES TO ADDRESS THEM. LAST YEAR, CHAIRMAN NICKLES, YOU INTRODUCED S.1302, A BILL TO DECONTROL NEW AND RENEGOTIATED CONTRACTS, AND, LAST MONTH, S.2205, A BILL TO ELIMINATE THOSE DEMAND RESTRAINTS IMPOSED BY THE FUEL USE ACT. SOME OF YOUR COLLEAGUES IN THE SENATE HAVE ALSO INTRODUCED BILLS AIMED AT CORRECTING DISTORTIONS IN GAS MARKETS. SENATOR DOMENICI'S S.1251, INTRODUCED LAST JUNE, WOULD REPEAL THE DEMAND RESTRAINTS IN CURRENT LAW. MORE RECENTLY, SENATOR GRAMM INTRODUCED S.2217. THIS BILL PROVIDES FOR TOTAL WELLHEAD DECONTROL, ELIMINATION OF DEMAND RESTRAINTS, AND A FORM OF OPEN ACCESS CARRIAGE. I WANT TO TAKE THIS OPPORTUNITY TO EXPRESS MY APPRECIATION FOR THE INTEREST YOUR EFFORTS AND THOSE

OF YOUR COLLEAGUES REFLECT, AND TO REQUEST YOUR CONTINUED SUPPORT IN THIS AREA. THE REFORMS PROPOSED BY THESE BILLS ARE NECESSARY. WE CONTINUE TO BELIEVE, HOWEVER, THE ROOT CAUSES OF DISTORTIONS IN CURRENT GAS MARKETS CAN BE SOLVED ONLY BY COMPREHENSIVE REFORM LEGISLATION THAT INCLUDES THE ELIMINATION OF ALL REMAINING WELLHEAD PRICE CONTROLS ALONG WITH REMOVAL OF DEMAND RESTRAINTS AND A STRONG OPEN ACCESS CARRIAGE PROVISION. THE PRESIDENT'S LEGISLATION ENCOMPASSES ALL THREE OF THESE SOLUTIONS.

IT WAS NOT LONG AGO OUR NATION SUFFERED FROM SEVERE SHORTAGES OF NATURAL GAS, NOT BECAUSE WE HAD RUN OUT OF GAS, BUT BECAUSE FEDERAL PRICE CONTROLS HAD DISCOURAGED DOMESTIC GAS PRODUCERS FROM FINDING AND DEVELOPING NEW GAS RESERVES. THERE WAS MUCH TALK DURING THE GAS CURTAILMENTS OF THE MID-1970'S ABOUT A CRISIS IN NATURAL GAS PRODUCTION. MANY BELIEVED WE HAD USED UP OUR GAS RESOURCES AND COULDN'T PRODUCE ENOUGH TO KEEP UP WITH DEMAND.

WELL, THERE WAS INDEED AN ENERGY CRISIS DURING THE 1970s, BUT IT TURNED OUT THAT -- IN MANY WAYS -- THE HEART OF THE CRISIS WAS NOT IN THE GAS FIELDS, BUT ON THE BANKS OF THE POTOMAC. THE PROBLEM WASN'T THAT OUR ENERGY RESOURCES WERE DISAPPEARING OR THAT AMERICANS WERE USING TOO MUCH ENERGY. THE PROBLEM WAS THAT OUR NATION'S LEADERS DIDN'T HAVE FAITH IN COMPETITIVE FORCES IN THE MARKETPLACE TO SOLVE THE PROBLEM OF ENERGY SHORTAGES AS QUICKLY AS THOSE FORCES HAD SOLVED SIMILAR PROBLEMS IN THE PAST.

AS ONE OF THE FIRST ACTS OF HIS ADMINISTRATION, PRESIDENT REAGAN DECONTROLLED THE PRICE OF OIL. THE RESULTS WERE EVIDENT VERY QUICKLY. SINCE DECONTROL, THE PRICE OF OIL HAS DECLINED DRAMATICALLY. ONE ONLY HAS TO LOOK AT PRICES AT THE GAS PUMP TO SEE HOW WELL A MARKET-BASED ENERGY POLICY WILL WORK, IF GIVEN A CHANCE.

WE HAVE SUCCEEDED IN LAYING A FOUNDATION OF ENERGY STABILITY AND SECURITY IN THESE LAST FIVE YEARS. THE OUTLOOK FOR CONTINUING THIS PROGRESS AND FOR OUR ENERGY FUTURE IS BRIGHT, IF WE APPLY THE SAME MARKET-ORIENTED SOLUTIONS TO NATURAL GAS, A RESOURCE WHICH IS OF EXTREME IMPORTANCE TO OUR NATION.

WE HAVE MADE PROGRESS TO THIS END. WITHOUT QUESTION, PARTIAL DECONTROL HAS SHOWN GAS SUPPLIES AND PRICES WILL RESPOND FAVORABLY TO MARKET FORCES. AN ADDITIONAL NINE TRILLION CUBIC FEET OF GAS, OR 50 PERCENT, OF GAS SUPPLIES WERE DEREGULATED ON JANUARY 1, 1985. CONTRARY TO SOME PREDICTIONS, AVERAGE WELLHEAD PRICES FELL IN 1985 IN REAL TERMS, AND PRICES TO ALL TYPES OF CONSUMERS AS WELL. PARTIAL DECONTROL PROMOTED GREATER COMPETITION FOR SUPPLIES, MORE CONTRACT FLEXIBILITY, AND A LESSENING OF MARKET DISTORTION. HOWEVER, THE FULL BENEFITS OF COMPETITION WILL NEVER BE REALIZED UNTIL THERE IS OPEN ACCESS TO TRANSPORTATION AND THE REGULATORY OBSTACLES TO FULL PRODUCTION OF ALL OUR LOW-COST, OLD GAS SUPPLIES ARE REMOVED.

THE LEGISLATION SENT ON BEHALF OF THE PRESIDENT TO CONGRESS PROVIDES FOR OPEN ACCESS, ELIMINATES ALL REMAINING CONTROLS ON NATURAL GAS PRICES, AND REMOVES DEMAND RESTRAINTS. WE CAN ALL AGREE DISCRIMINATION IN TRANSPORTATION HINDERS COMPETITION. TO THE EXTENT IT EXISTS, DISCRIMINATION IS AT ODDS WITH THE CONGRESSIONAL DETERMINATION IN THE NATURAL GAS POLICY ACT THAT THE WELLHEAD MARKET IS COMPETITIVE AND CONSUMERS ARE BEST SERVED BY LETTING COMPETITIVE FORCES WORK. THE FEDERAL ENERGY REGULATORY COMMISSION HAS MOVED IN THE DIRECTION OF BRINGING PRODUCERS AND CONSUMERS TOGETHER BUT, UNFORTUNATELY, NONDISCRIMINATORY ACCESS STILL DOES NOT EXIST. OPEN ACCESS TO TRANSPORTATION WOULD ELIMINATE DISCRIMINATION IN THE NATURAL GAS MARKET, THEREBY ALLOWING ALL CONSUMERS TO SEEK THE LEAST COSTLY SUPPLIES AVAILABLE. BY REMOVING BARRIERS TO OPEN TRANSPORTATION, THE PROPOSED BILL WOULD PERMIT WILLING BUYERS AND SELLERS TO DEAL DIRECTLY TO BRING LOW-COST, CURRENTLY SHUT-IN GAS FROM THE FIELD TO MARKET.

IT IS COMPLETELY UNACCEPTABLE FOR GOVERNMENT REGULATIONS TO PREVENT FULL UTILIZATION OF LOW-COST, OLD GAS SUPPLIES AT A TIME WHEN OUR NATION IS STILL DEPENDENT ON POSSIBLY INSECURE OIL SUPPLIES FOR A SIGNIFICANT PORTION OF ITS ENERGY NEEDS. LEGISLATIVE DECONTROL IS THE BEST SOLUTION TO THIS MARKET DISTORTION.

ANYONE WHO UNDERSTANDS THE RISKS ASSOCIATED WITH EXPLORING FOR AND PRODUCING NATURAL GAS KNOWS THE PROBLEMS CAUSED BY PRICE

CONTROLS. PRICE CONTROLS PREVENT PRODUCTION AND USE OF OUR LEAST-COST RESOURCES AND LEAD TO GAS SHORTAGES. CONGRESS RECOGNIZED THIS FACT IN PASSING THE NATURAL GAS POLICY ACT.

DURING THE NGPA DEBATE, MANY PEOPLE ARGUED PRICES WOULD RISE DRAMATICALLY, OR "FLY-UP," IF PRICE CONTROLS WERE PARTIALLY REMOVED FROM GAS. MANY OF THESE SAME PEOPLE CONTINUED TO PREDICT A PRICE FLY-UP UNTIL JANUARY 1 OF LAST YEAR. THE FLY-UP NEVER OCCURRED. IN FACT, REAL PRICES HAVE DECLINED SINCE PARTIAL DECONTROL TOOK EFFECT. THOSE WHO PREDICT A PRICE FLY-UP IF PRICE CONTROLS ARE FULLY REMOVED DO SO ON THE BASIS OF THE SAME FAULTY REASONING. THEY WERE WRONG THEN. THEY ARE WRONG NOW.

WHAT THE EVENTS SINCE PARTIAL DECONTROL DEMONSTRATE IS THAT, IF GIVEN THE CHANCE, THE MARKETPLACE WILL WORK FOR CONSUMERS, INDEED FOR THE ENTIRE INDUSTRY. IF WE WANT TO ACHIEVE ALL OF THE BENEFITS OF OUR COMPETITIVE SYSTEM, WE MUST MOVE FORWARD TO LET THE MARKET WORK TO PRODUCE ALL OUR NATURAL GAS.

I BELIEVE OUR LEGISLATION WILL HAVE THREE MAJOR BENEFITS FOR AMERICAN GAS CONSUMERS VERSUS THE STATUS QUO.

NAMELY,

- AMERICAN CONSUMERS WILL PAY SIGNIFICANTLY LOWER PRICES FOR THEIR GAS SUPPLIES;

- SUBSTANTIAL ADDITIONAL AMOUNTS OF OLD GAS WILL BE MADE AVAILABLE TO CONSUMERS; AND

- COUNTERPRODUCTIVE MARKET DISTORTIONS, INCLUDING THE PERSISTENT SURPLUS, WILL BE ELIMINATED.

DECONTROL WILL BRING LOWER PRICES FOR CONSUMERS. EVEN THOUGH SOME OLD GAS PRICES WILL INCREASE UNDER DECONTROL, AVERAGE PRICES PAID BY CONSUMERS WILL BE LOWER OVER THE NEXT DECADE. THIS WILL BE THE CASE BECAUSE LOW-COST GAS PRODUCTION WILL INCREASE AND DISPLACE SOME NEW, HIGH-COST, AND IMPORTED GAS. IN ADDITION, GIVEN THE CURRENT MARKET CONDITIONS OF SUPPLY SURPLUS AND STRONG INTRA- AND INTERFUEL COMPETITION, THE PRESSURE ON PRICES WILL CONTINUE. AS THE EVENTS FOLLOWING PARTIAL DECONTROL OF NATURAL GAS SHOWED SO CLEARLY, MARKET FORCES CANNOT BE IGNORED.

OUR ANALYSIS SHOWS AVERAGE WELLHEAD PRICES WILL DECLINE BY ABOUT $0.10 TO $0.20 PER MCF ANNUALLY ON AVERAGE FROM 1987 TO 1995 AFTER DECONTROL COMPARED WITH CURRENT NGPA POLICY. FOR THE ECONOMY, THE BENEFITS WILL BE ABOUT $16 BILLION TO $24 BILLION OVER THIS PERIOD.

DECONTROL WILL BRING TO MARKET LOW-COST, OLD GAS RESERVES THAT WILL NEVER BE PRODUCED UNDER THE CURRENT REGULATORY SCHEME. PRODUCTION OF THESE RESERVES IS PREVENTED BY OUR PRESENT, OUTMODED SYSTEM OF PRICE CONTROLS. BRINGING THEM ONTO THE MARKET

IN AN ORDERLY WAY WOULD PROMOTE OUR NATION'S ENERGY SECURITY BY LOWERING OIL IMPORTS AT THE SAME TIME IT WOULD BOOST THE ECONOMY.

OUR ANALYSIS INDICATES SOME 30 TO 34 TRILLION CUBIC FEET OF OLD GAS WILL BE ADDED TO OUR SUPPLY UNDER FULL DECONTROL. THIS RESPONSE WILL OCCUR OVER TIME AT AN AVERAGE ANNUAL RATE OF ABOUT 750-850 BILLION CUBIC FEET. I WANT TO EMPHASIZE WE ARE NOT ALONE IN EXPECTING AN OLD GAS SUPPLY RESPONSE. YOUR OWN OFFICE OF TECHNOLOGY ASSESSMENT, SHELL OIL COMPANY, AND OTHERS HAVE SIMILAR ANALYSES.

THESE ADDITIONAL OLD GAS SUPPLIES BENEFIT AMERICAN CONSUMERS WHO WILL CONSUME MORE GAS AT LOWER PRICES. THE SURPLUS HAS PERSISTED FOR YEARS BECAUSE SOME PRODUCERS HAVE DEMANDED A HIGHER PRICE FOR THEIR GAS THAN CONSUMERS HAVE BEEN WILLING TO PAY. THESE PRODUCERS HAVE BEEN ABLE TO GET THIS PRICE, IN LARGE PART, BECAUSE THE PRICE OF LOW-COST OLD GAS HAS BEEN ROLLED-IN WITH AND USED TO SUBSIDIZE HIGHER COST GAS. IN ADDITION, EXISTING PRICE CEILINGS HAVE DISCOURAGED PRODUCTION OF CHEAPER ALTERNATIVE SOURCES OF GAS. OUR BILL WILL CHANGE THIS SITUATION BY ELIMINATING THE PRICE CUSHION AND BY INCREASING THE SUPPLIES OF LOW-COST, OLD GAS.

AS A DIRECT RESULT, PRODUCERS OF NEW, HIGH-COST, AND IMPORTED GAS WILL NO LONGER BE ABLE TO DEMAND ABOVE-MARKET PRICES FOR THEIR GAS AND WILL OFFER THESE SUPPLIES AT MARKET-CLEARING PRICES. AT THE SAME TIME, CHEAPER OLD GAS SUPPLIES WILL REPLACE

NEW SOURCES OF MORE EXPENSIVE NEW AND HIGH-COST GAS SUPPLIES IN THE NEAR AND LONG TERM. THESE MORE EXPENSIVE SUPPLIES WILL BE PRODUCED LATER, WHEN IT IS ECONOMIC TO DO SO. THIS MORE EFFICIENT PRODUCTION OF OUR GAS SUPPLIES WILL RESULT IN THE FULL ECONOMIC DEVELOPMENT OF OUR DOMESTIC GAS RESOURCES. AS A RESULT, AMERICANS WILL RECEIVE THE GAS THEY NEED AT REASONABLE PRICES IN THE NEAR AND LONG TERM.

FINALLY, THE PROPOSED LEGISLATION WOULD REMOVE CERTAIN DEMAND RESTRAINTS CURRENTLY IMPOSED BY THE FUEL USE ACT AND THE INCREMENTAL PRICING SYSTEM. I THINK THERE IS AGREEMENT THROUGHOUT THE INDUSTRY THAT THESE RESTRAINTS RESULT IN MARKET DISTORTIONS WHICH ARE COUNTERPRODUCTIVE AND COSTLY, AND SHOULD BE REMOVED.

THIS LEGISLATION DOES NOT DEAL WITH TAKE-OR-PAY. WE BELIEVE THE SCOPE OF THIS "PROBLEM," TO THE EXTENT IT NOW EXISTS, HAS BEEN GREATLY EXAGGERATED. ANY PIPELINE-SPECIFIC SITUATIONS CAN BE TAKEN CARE OF THROUGH NEGOTIATION BY THE CONTRACTING PARTIES AND CERTAINLY DO NOT REQUIRE GOVERNMENT INTRUSION INTO PRIVATE CONTRACTS THROUGH IMPOSITION OF A GENERIC SOLUTION. INDEED, PARTIES HAVE BEEN ADDRESSING THIS ISSUE SUCCESSFULLY THROUGH RENEGOTIATION. THEY WILL CONTINUE TO DO SO. OUR BILL WILL INTENSIFY COMPETITIVE PRESSURES AND LEAD TO CONTINUED RENEGOTIATION OF NONCOMPETITIVE CONTRACTS.

IT WAS ABOUT THREE YEARS AGO THAT THIS ADMINISTRATION FIRST SOUGHT FULL DECONTROL OF NATURAL GAS. THE CONGRESS - AT THAT TIME - WAS NOT CONVINCED THE WEIGHT OF EVIDENCE SUPPORTED COMPREHENSIVE DECONTROL.

TODAY, THE EVIDENCE IN SUPPORT OF COMPREHENSIVE DECONTROL IS IN. WE HAVE THE EXPERIENCE OF PARTIAL DECONTROL BEHIND US, AND THE EVIDENCE IS COMPELLING. IT IS CLEAR THE BENEFITS OF INCREASED COMPETITION, AND LOWER PRICES, ARE NOT TRANSITORY. STILL GREATER BENEFITS WOULD BE REALIZED UNDER COMPREHENSIVE DECONTROL. THE FACTS SHOW THAT FULL DECONTROL WILL BENEFIT INDUSTRY, CONSUMERS, AND THE ECONOMY. THIS LAST POINT IS AN IMPORTANT ONE. NO LONGER SHOULD THIS ISSUE BE SEEN AS A PRODUCER VS. CONSUMER ONE. REGULATORY REFORM BENEFITS EVERYONE.

I URGE THE CONGRESS TO SET ASIDE THE DIVISIVE POSITION OF THE PAST AND WORK TOGETHER TO PASS THIS LEGISLATION. I STAND READY TO WORK WITH EVERYONE IN CONGRESS TO FINISH THE JOB. I URGE YOU AND YOUR COLLEAGUES TO CONSIDER OUR BILL CAREFULLY, AND MOVE PROMPTLY TOWARD ITS ENACTMENT.

Senator NICKLES. Thank you, very much, Mr. Secretary. I appreciate your appearance before the committee and I also appreciate finally the administration coming up with their bill that we have been looking for and working on and hoping to receive for some time.

I also will comment that Senator Johnston and Senator McClure and others on this committee would like to be here—I think Senator Evans, but they are involved in the hydro bill that is currently on the floor. I expect that they will be joining us in the not too distant future. We will wait their arrival.

A few quick questions. In looking at the legislation which Senator McClure has introduced at the request of the administration, you have an access provision. You have repeal of certain wellhead price controls. To touch on that just for a moment, on repeal, removal of price controls on natural gas.

A lot of people—let me just ask you this question: What percentage of natural gas is still under some form of price restraint?

Secretary HERRINGTON. We estimate 45 percent.

Senator NICKLES. Forty-five percent of existing contracts. What part of that would be your 104's? Is that the majority of it?

Secretary HERRINGTON. I think we would say, in answer to that, the majority would be under section 104.

Senator NICKLES. I am just kind of looking at some of the other categories of gas. I think a lot of people—I am sure it is the majority—I am trying to delve into that a little further. Maybe if your staff could provide that for the committee, the percentages.

We still have, and correct me if I am wrong, we still have price controls under some sections of 102. Is that correct? OCS 102(d), is that correct?

I would like, if you could give us, the volumes and amount of gas in each one of these categories that are still under regulation. That is what I am looking for. Do you have that now by any chance?

Secretary HERRINGTON. Not with us, but we could submit it.

[The information follows:]

Most gas sold in the intrastate market was decontrolled on January 1, 1985. Some additional volume of gas from infill wells drilled in existing fields at a depth of less than 5000 feet ("new" section 103 gas) will be decontrolled in 1987. Gas that will remain under NGPA price controls indefinitely includes the following NGPA sections:

o	Section 102(d)	new offshore gas
o	Section 103	old infill well gas
o	Section 104	old interstate gas
o	Section 105	old intrastate less than $1.00/mmBtu
o	Section 106(b)	old interstate "rollover" contracts
o	Section 107	high-cost, "tight" gas
o	Section 108	stripper gas
o	Section 109	other controlled gas

We have examined volumes of these categories of gas that are currently being purchased by interstate pipelines. These volumes are taken from the most recent projections for 1986 made available by interstate pipelines. This data understates the share of old interstate gas (Section 104) of total remaining controlled supplies. We estimate that more than one trillion cubic feet of this gas is currently being shut-in by producers and pipelines.

Based on current purchase volumes, about one-fourth of controlled supplies are being sold at average prices that are significantly lower than their ceiling price. About three-fourths of supplies that remain under controls are low-cost old gas supplies (primarily Section 104 and 106 gas). The attached table shows the projected 1986 volumes by NGPA category of controlled gas supplies purchased by interstate pipelines.

Estimated 1986 volume of Controlled Gas Purchases by Interstate Pipelines

Category	Volume (bcf)	% of Controlled Gas Purchases	Avg. Price ($/mmBtu)	Ceiling Price ($/mmBtu)
102(D) new offshore gas	664.5	14.4	3.67	4.24
103 new infill wells less than 5000 feet	339.6	7.3	3.05	3.67
old infill wells	9.9	0.2	3.04	3.09
104 pre-73	916.6	19.8	0.58	0.57
73-74	244.0	5.3	1.83	1.91
post-74	767.0	16.6	2.60	2.56
pre-73 recompletions	554.2	12.0	1.05	1.07
105 intrastate old	51.8	1.1	2.26	4.19
106(b) interstate rollovers	323.1	7.0	1.04	0.95
warranty gas	377.8	8.2	0.57	0.57
intrastate rollovers	18.6	0.4	2.05	1.77
108 stripper well gas	195.6	4.2	3.75	4.54
109 other controlled	163.2	3.5	2.57	2.56
Total Controlled Purchases	4625.9	100.0		

Source: Based on annualized field purchase data from PGA filings in effect on 5/1/86 by 30 major interstate pipelines. Average prices include taxes and gathering costs and may, therefore, appear to exceed ceiling prices for some categories. Section 103 new infill wells less than 5000 feet will be decontrolled in 1987.

Senator NICKLES. If you would submit it, I would appreciate it. We still have some 103 under price controls, is that correct?

Secretary HERRINGTON. Yes, it is.

Senator NICKLES. Prices have ranged, $3.61, I think, in looking at—Is that correct?

Secretary HERRINGTON. Yes.

Senator NICKLES. $3.61.

Secretary HERRINGTON. 103?

Senator NICKLES. 103(b). I am looking at two different charts. One says $3.09 and the other one says $3.61 for 1986.

Secretary HERRINGTON. The $3.61 throws me a little bit. I need to look at that.

Senator NICKLES. If you would supply the committee again, the volumes of each of these categories that show regulated and current prices, what those prices are today under the regulated scheme, and what they would be in 1986. Some, I think, are deregulated on a date-specific in 1987. I just want to make sure that we are all working with the same information.

But the point I am making is that we still have regulated categories of gas that are in excess of market prices and we have regulated categories of gas that are below market prices. Isn't that correct?

Secretary HERRINGTON. I think that is right.

Senator NICKLES. We still have I don't know—how many different categories of gas prices do we have today? Do you happen to have that figure?

Secretary HERRINGTON. Fourteen categories of vintage levels, out of a total 26.

Mr. GARRISH. There are still 14 categories of vintage old gas, alone, and 26 originally under the NGPA. Some of those have been decontrolled.

Senator NICKLES. If you could kind of give us a little schematic chart of the various categories. We wrestled with this when we were wrestling with natural gas for a couple of years on this committee. I think it is important. Again, I want all of us to be looking at the same thing.

But your bill, Mr. Secretary, you are calling for deregulation. Basically the elimination of price controls or restraints on all contracts—correct me if I am wrong—contracts that are below the market price, and also for some that would still be above market price.

Secretary HERRINGTON. Yes.

Senator NICKLES. Do you abbrogate those contracts?

Secretary HERRINGTON. No. We are not advocating abrogation. We only affect contracts that already have provisions, that respond to decontrol, or contracts that are voluntarily renegotiated.

About two-thirds of the old gas contracts contain clauses that allow old gas prices to immediately go to market levels. One-third of the old gas contracts contain provisions that must be voluntarily renegotiated to allow prices to reach market levels.

Senator NICKLES. Those contracts that provide for voluntary renegotiation, do you do anything with those contracts, or do you just allow those to be renegotiated at whatever price the two parties would agree to?

Secretary **Herrington**. That is correct.

Senator **Nickles**. But you do not go in and mandate that that gas that was selling for 50 cents would be selling for $1.80, or anything like that.

Secretary **Herrington**. It is not the intent of this legislation to abrogate existing contracts. I think we have covered that pretty well. I don't see any cases where we get into an abrogation situation.

Senator **Nickles**. So, as I am looking at it, you have done what we had—in the legislation which I introduced, which would allow old contracts to be renegotiated, voluntarily renegotiated, and also, as those contracts would expire, they can set their own level in the marketplace without Federal contraint.

Secretary **Herrington**. That is essentially correct, Mr. Chairman.

Senator **Nickles**. But you also went a little bit further in the fact that you do have some 102's and 103's, with prices ranging in the $4.20 range for some 102's, or OCS gas, and $3.00 gas in new onshore production wells, 103(b)'s; also some $3.60 for 103's, some $4.00—You are basically saying for those contracts, that they also should be set in the marketplace and should not be tied to any Government mandated schedule. Is that correct?

Mr. **Minihan**. Mr. Chairman, the way the legislation deals with that problem is that those particular contracts would continue in existence. It would be our hope that those contracts without deregulation provisions would be renegotiated to the market level eventually, but those contracts would continue in place.

Senator **Nickles**. Would those contracts—let's take the OCS contract that is in the $3.60. If a producer has a contract with a pipeline and they are selling that OSC gas say to Trunkline, or somebody, for $3.60, you don't go in and say—no, you can't do that tomorrow. What about the schedule that continues to escalate.

Mr. **Garrish**. If they have a valid contract, that contract would continue. As of April 1, 1987, under our legislation, we would have the lifting of controls so that well prices would no longer be set by the Federal Government.

Senator **Nickles**. Under existing NGPA, do they continue to escalate along the tracking schedule until July 1, 1987—is that correct?

Mr. **Garrish**. It would be April 1, 1987.

Senator **Nickles**. What happens at the end of that?

Mr. **Garrish**. At that date, those contracts would continue under whatever terms those contracts contain for deregulation, and if those contracts do not have a price, it would be up to the parties to renegotiate the price at that time.

Senator **Nickles**. Thank you, very much. We are going to try to stay on the 10-minute rule because I have feeling we are going to have a lot of Senators here, and we are going to go by order of appearance.

Senator Ford, you are next.

Senator **Ford**. Mr. Secretary, let's talk about a couple of items in your legislation. Talk about the area rate clause provision in your bill, and I believe that is section 203, your bill poses as a deregulation bill and I think maybe I am tracking Senator Nickles a little bit.

Section 203 certainly cannot be called, in my opinion, a deregulation section, can it?

Secretary HERRINGTON. I think you have pointed to the one area, obviously, Senator, that you could have a little problem with. Certain contracts written under full controls obviously contain clauses that are tied to regulated prices. In these contracts, prices are set at the original base year price, whenever it is greater than the regulated price.

We are concerned that the elimination of regulated prices will cause these contracts to revert to the low base-year price. To prevent this, we have included a portion, or a provision in the bill that maintains prices under these contracts at their current regulated level until these contracts are renegotiated.

Now that would be—I guess the price would be the last day before the enactment of the legislation. That would be the only case.

Senator FORD. The price would be the price on the day prior to the enactment?

Secretary HERRINGTON. Yes.

Senator FORD. Is that the signature of the President?

Secretary HERRINGTON. Yes, I would have to say it would be the signature of the President. That would be the intent, anyway.

Senator FORD. Now, under what you just said, I guess then that section 203 specifies that the last price paid while the gas was regulated—am I correct on that?

Secretary HERRINGTON. Yes.

Senator FORD. This gas will serve as a prop for contracts that have an area rate clause, but do not have an indefinite price escalator clause.

Secretary HERRINGTON. The word "prop" throws me a little bit.

Senator FORD. Yes, that is my term. You can accept it—hold it up, or a ladder—that is propped up against the wall—however you want to use it.

Secretary HERRINGTON. How about "maintain the status quo?"

Senator FORD. Your interpretation is probably more bureaucratic than mine, but I imagine people understand prop better than maintains the status quo. [General laughter.]

But it maintains the status quo, then?

Secretary HERRINGTON. Yes, sir. It does.

Senator FORD. I think we have established that your bill guarantees price increases for old gas, and then we can use maintains the status quo, or props up certain contracts that have area rate clauses, but do not have indefinite price escalators.

What authority does your bill provide for bringing gas prices down?

Secretary HERRINGTON. I think that is hard to say. I think you have to draw on the evidence of the deregulation effort that has taken place already on 50 percent to show what will happen when you put gas into the market and take out estimates of how much gas will come into the market based on deregulation.

Senator FORD. What we are doing here is establishing an increase in price, but we are not establishing any authority to bring prices down.

Secretary HERRINGTON. I think the overall effect is that we will see prices come down across the board. I think we will sell a lot more gas.

Senator FORD. Does your bill provide any market-out provision or any type of administrative relief for above market contracts?

Secretary HERRINGTON. No, sir; it does not.

Senator FORD. So there is no market-out provision, or any type of administrative relief for above market contracts. Under those circumstances, it is holding prices up—props the prices up.

Is it the administration's position that contract terms made be abbrogated only when that abrogation benefits the producer, rather than the consumer?

Secretary HERRINGTON. No, sir. I would not agree with that. I don't think our bill does abrogate contracts. I think we are adhering to what has been called in the business, I guess, contract sanctity. That is something that our bill attempts to address. I think the consumer benefits a lot from what we are attempting to do here.

Senator FORD. How does the consumer benefit when you don't allow prices to come down and you let the old prices go up?

Secretary HERRINGTON. I think you change the mix of gas that is in the pipeline. Our figures show a reduction in the average utility bill. Under my opening statement, we put it at between $25 and $45 per consumer per year. I think that is a lot.

I think we allow recovery of 30 to 34 trillion cubic feet—more. It is an all-American product. It benefits the economy. We put in at about $24 billion.

The consumer gets a lot of benefit out of this decontrol.

Senator FORD. Well, that is the first time I have ever heard all-American to include Canada.

What incentive is there for the producer to renegotiate in this particular context?

Secretary HERRINGTON. The subsidy of low-cost gas is gone. He must renegotiate the contract. I think there would be an incentive to do that.

Senator FORD. You mean, this just gives an incentive to do that?

Secretary HERRINGTON. Yes.

Senator FORD. Well, you know, it seems to me that high-cost contracts should be afforded some relief in exchange for decontrol of old gas, shouldn't there be?

Secretary HERRINGTON. I don't think that is our position.

Senator FORD. You don't think it is?

Secretary HERRINGTON. No. I think we ought to honor existing contracts.

Senator FORD. And then decontrol old gas, keep the gas price high under honoring those old contracts, and then deregulate old gas and let that go up, so there is no way to bring anything down.

Secretary HERRINGTON. I think the result of allowing the old gas to go up and increasing the supply on the market will necessarily bring the price down.

Senator FORD. Will it bring the price down of all Btu-related products?

Secretary HERRINGTON. I can't answer that. You are referring to coal and other——

Senator FORD. Coal, oil, whatever—Btu-related products, resources.

Secretary HERRINGTON. I think we can be sure to say that it will reduce oil demand. I don't know what my answer would be on coal.

Senator FORD. Let me ask you a question. We went through a problem of embargo in 1973 and later in the 1970's with the scare in Iran. Where we had a shortage of oil, coal was in somewhat of a demand. But if we continue on the pace, or track we are on, we are going to find that there will not be any provisions for coal as it relates to, say, generating facilities. They will be left out. And if we have a shortage of gas or oil, where do we fall then if we do not have any coal capability in those particular generating facilities?

Secretary HERRINGTON. I think we must be careful to keep the alternative or the management decision to use coal as an alternative, because I think your point is very good; we can't count on low crude oil prices or low natural gas prices or any other prices indefinitely.

I think that we need to keep the way open for that type of management decision and option.

Senator FORD. Mr. Chairman, I know my 10 minutes is up, but let me follow this.

Unless there is some provision in the Federal law as it relates to coal-capable, the States will not require the use of coal—it would be some other product. Would you tend to look favorably upon a provision for coal-capable?

Secretary HERRINGTON. I think we would like to look at it. I don't have an opinion here this morning.

Senator FORD. Thank you, Mr. Chairman.

Senator NICKLES. Senator Domenici.

Senator DOMENICI. Thank you, very much, Mr. Chairman. Mr. Secretary, it is good to be with you.

Let me tell you that I personally have not had a chance to review the administration's deregulation proposal in any depth for purposes of this hearing. However, I do understand that while it may have some shortcomings in other areas, as it applies to this Senator, you have made an effort to rid this decontrol bill of a provision that was very onerous to my independents, and obviously to me, and eventually the position of the independents in New Mexico became almost the position nationally, and that was the mandatory abrogation contract provisions.

As I understand it, without going through all the rest of the details, it is your position that you do not know oppose the mandatory abrogation of the existing contracts. Is that correct?

Secretary HERRINGTON. That is correct, Senator.

Senator DOMENICI. Mr. Secretary, you know that the chairman of this committee and this committee spent enumerable months trying to get a deregulation bill through—probably as difficult a job for Chairman McClure as anything he has had. I am only speaking as an observer, but I have been with him and served with him for a long time.

After all that effort, it was literally, as I understand it, to no avail. What makes you think that we are going to succeed, having taken all that time and gotten nowhere—what makes you think we are going to succeed this year?

Secretary HERRINGTON. The legislative agenda that you have is extremely complicated. I understand that. There are some changed circumstances here. No. 1 is the overall energy situation in this country and the falling oil prices.

The threat of being dependent once again on imports, to a level far above where we are today, which is roughly 27 percent. The high was in 1977, at about 46 to 47 percent. With low oil prices, we may be going back to that type of situation.

I think it behooves us to get more energy sources on the market and available to the American consumers, give them greater choices, more indigenous-type energy.

To do that, this bill is basically a transportation bill. This bill attempts to open up transportation to get this product to consumers. I think that is a changed circumstance.

Senator DOMENICI. Mr. Secretary, you have had an opportunity, not only for this hearing, but on prior occasions to review the Domenici-Johnston stripped-down bill which would have done away with the Fuel Use Act in its entirety and incremental pricing, and I want to just ask you, do you support that?

Secretary HERRINGTON. Sir, I have some reservations, if I could explain myself. I think the motives behind that are excellent, and I think it heads in the right direction.

The thing that concerns me is the Fuel Use Act applications for exemptions are being routinely granted at the Department of Energy. I don't think that the Fuel Use Act is inhibiting any activity today. Yet, I don't see the transportation situation changing. I think that a stand-alone repeal of some provisions of the Fuel Use Act—not the whole act—does not solve the problem, unless we couple it with opening up the transportation.

Senator DOMENICI. Mr. Secretary, that is perhaps a realistic approach if you were to say the Fuel Use Act elimination and the repeal of incremental pricing does not solve the natural gas problem in this country to the extent that it might be solved with other and further legislation.

If that is what you are saying, you don't have any disagreement from this Senator. Is that what you are saying?

Secretary HERRINGTON. That is what I am saying.

Senator DOMENICI. So, Mr. Secretary, how long do you think we ought to wait if, as a matter of fact, we cannot get a deregulation bill out of this committee, how long should we wait before we eliminate the Fuel Use Act and incremental pricing?

Let me say, I would argue with you on the point of FERC granting exemptions to the Fuel Use Act. That is true, but the loss of time, the cost, and the loss markets are enormous just because it is taking at least 7 months and in many instances 1 full year to get the Fuel Use Act exemptions through. It is also inhibiting significantly any planning for use of natural gas a mix with dirty coal, as a method of cleaning up some of the Midwestern facilities that are contributing to acid rain.

That Fuel Use Act, plus incremental pricing, is causing a lot of difficulty.

I shouldn't say FERC; it is DOE that is granting the exemptions. And I am not arguing that you should do it faster, it is just very difficult.

So, let me just ask you: Do you think 3 months would be long enough to wait before we proceed with something that we could do, that has some good effects on the marketplace—6 months—the rest of your term, assuming you serve out the remainder of President Reagan's term? How long should we wait before we do something?

Secretary HERRINGTON. It is hard this morning to say 3 months, 6 months, or 3 years—I assure you that I intend to be in this job until the end of the term.

Senator DOMENICI. I made that as a part of my hypothetical.

Secretary HERRINGTON. It is hard to put a time limit on it. It is my feeling that the opportunity, plus what we saw happen last year in the partial decontrol, gives enough proof as to what will happen on this decontrol effort, and you add to that the fact that of some of the industry problems that are taking place in the chairman's State, Texas and some of those other producing States—Louisiana——

Senator DOMENICI. New Mexico.

Secretary HERRINGTON. People want to do something on this important industrial base—add those all together and I think it can be done—all of it can be done now. I don't think you have to settle for a partial action at this point. I would rather not put a time limit on it.

I want to see progress in this area, just like you do, and some of the other members, but I don't think we can put a time limit at this point.

Senator DOMENICI. Mr. Secretary, is partial action before this year is out better than nothing?

Secretary HERRINGTON. That is hard for me to answer. I don't know that I can answer that sitting here this morning. I have reservations, Senator, about going after just the Fuel Use Act, if you don't solve the transportation problem. The temptation will be to say—look, we have done enough, and everything is fine again. A lot of us who watch the facts and figures and the computer models know that it is not enough and we are not opening up this transportation.

Senator DOMENICI. Mr. Secretary, is no significant amelioration of the transportation problem occurring?

Secretary HERRINGTON. I would say it is still a major problem. The order 436, in the way that it has been applied and the number of people that have signed up for it, and the grandfathering provisions—we have not gotten the desired result.

Senator DOMENICI. That wasn't my question. Without your bill, is not the transportation problem being somewhat alleviated? Is there not more transportation in nonpipeline gas occurring today than 3 years ago?

Secretary HERRINGTON. I would agree with that.

Senator DOMENICI. You think there is some?

Secretary HERRINGTON. There is some.

Senator DOMENICI. I guarantee you there is some; it is substantial in certain pipelines. It is sporadic, not universal, but substantial.

Let me say to the chairman of the subcommittee, I compliment you for your bill, for conducting these hearings. I do want to say from my standpoint, and I think I speak for Senator Johnston, clearly, everyone knows of our great concern in terms of deregulation. But I disagree wholeheartedly with the Secretary. I believe that if this committee cannot report out a deregulation bill, there is no committee in the Congress that can report one out that is satisfactory to the Secretary and to this committee.

You cannot look to the House to do this Secretary's bill, from what I can tell, and consequently I would think that only a reasonable amount of time ought to be used. It is up to the chairman, but I will share it with him—the chairman of the full committee—if we cannot get it done, we ought to move with something, and the Fuel Use Act and incremental pricing has seen their day in my opinion.

Your markets, Mr. Chairman, and mine are dwindling rapidly. We could come up with a list as long as your arm and mine combined that we might call our druthers, our wish list, and it might even be longer than the Secretary's, included in his bill. But, sooner or later, wish lists have to yield to reality, and I truly believe we have to move while there is all the crisis in the world out there with something that will give us a better chance of selling more natural gas. If we cannot get it all, we ought to proceed with some piece of it.

Thank you for holding the hearings.

Senator NICKLES. Senator Domenici, thank you. I appreciate the support that you have shown in the bill that you have introduced. I have introduced identical legislation in the last three Congresses, and I agree with your assessment; we need to move forward on some legislation. If we can do a more comprehensive bill, fine. If we cannot, we want to move forward with some positive natural gas legislation this year.

Senator Warner.

Senator WARNER. Thank you, Mr. Chairman. Welcome to you, Mr. Secretary. You have sunk your teeth in a tough challenge, and since we are obligated, those of us from energy States, to consider as a part of any proposal as yours the impact on our State and our principle sources of energy, I would turn to coal. I have some ambivalence about the repeal of the Fuel Use Act, and ask you, what are the long-term implications of the coal industry if we were to repeal the Fuel Use Act?

Secretary HERRINGTON. I think I would give a general response. The response would be that all fuels need to compete in the marketplace; natural gas and coal. We are not trying to inhibit the use of coal by this, or in any way hurt that. We need to get more choices, more selections for consumers and users.

Senator WARNER. Well, indirectly the act contributes to the use of coal and I question whether it would have any short-term advantages to my colleagues from the gas-producing and the oil States, but time will tell.

Is there not some affirmative proposition that the administration could take to encourage the increased production and use of American coal?

Secretary **Herrington**. We would consider very seriously and carefully any provision like that, because I do believe that we need to encourage more usage of coal.

Senator **Warner**. As we are here this morning, the world is gripped in a crisis, and we cannot overlook the possibility that one of the sanctions taken against this Nation for the actions that our President directed yesterday, for which we have expressed our support in this time of need for our President, would be an embargo of primarily oil against this country. And, once again, we would fall back on the largest reserve of energy we have known to us, and that is coal.

We keep oscillating between these crises, back and forth. Once we are out of them, we tend to forget the crisis that preceded. So I think that we have to do more than just give lipservice to the need for this Nation to have a long-term program which predicates a substantial part of our energy usage on our largest natural resource, namely coal.

Secretary **Herrington**. Yes, sir.

Senator **Domenici**. Senator Warner, thank you, very much. Senator Bingaman.

Senator **Bingaman**. I have a short statement I will just put in the record, Mr. Chairman. I appreciate you holding these hearings.

[The prepared statement of Senator Bingaman follows:]

STATEMENT BY SENATOR JEFF BINGAMAN
SUBCOMMITTEE ON ENERGY REGULATION AND CONSERVATION
HEARING ON S.1302, S.1251, S. 1302, S. 2205 and S. 2285
APRIL 15, 1986

I thank the Chairman for holding this hearing on pending legislation to amend the Natural Gas Policy Act of 1978 and the Powerplant and Industrial Fuel Use Act of 1978. I hope the Committee will be able to take action on these bills during this session.

As a Senator from a producing state, I strongly support efforts to decontrol natural gas. Decontrol will bring lower prices for consumers by bringing to the market low-cost, old gas reserves that are not being produced under our current regulatory structure. Bringing these supplies onto the market will certainly help make production more efficient for our producers and result in lower energy costs as consumers take advantage of lower prices.

I am pleased to be a co-sponsor of Sen. Domenici's bill, S. 1251 which repeals the Fuel Use Act and the incremental pricing system. The repeal of the Fuel Use Act is overdue. The Act currently prohibits the burning of oil and gas in new power plants and prohibits the building of plants without alternate fuel capability. These restrictions make little sense during today's gas surplus. The incremental pricing system also needs to be repealed. Under incremental pricing, "low priority users," such as fuel-switchable industries, must pay the highest share of a pipeline's gas purchase costs. This system is no longer necessary.

I look forward to hearing the testimony of all witnesses today and in working with the Chairman to seek Committee action on these issues.

Senator NICKLES. Thank you, very much.

Mr. Secretary, just a couple of quick questions. I am going to try to move as quickly as possible. Just as kind of a followup question, on the Fuel Use Act, Senator Domenici alluded to, Senator Ford talked about it—he wanted to talk about coal-capable. Just a quick question, is there any other law on the books anywhere that mandates that one commodity couldn't be used for something?

In other words, you have to be off of natural gas, you have to be off of any other commodity that you are aware of?

Secretary HERRINGTON. I don't think I am aware of any. I could be wrong, but I have not heard of any.

Senator NICKLES. Does it not make sense that we eliminate that kind of arbitrary congressionally mandated prohibition of the Fuel Act? I can tell Senator Ford or Senator Warner, or anyone else, our State is a big coal State, as well. I don't want to mandate one fuel versus another. I just personally think that the marketplace should be making the decision as to which fuel they should burn. Don't you agree?

Secretary HERRINGTON. Yes; the marketplace should make that decision, but I think the points that have been raised by Senator Ford and a couple others, that market prices don't always stay low in one fuel. If I were a director on some of these companies, you want to keep your options open. It seems to me prudent that you keep all capabilities in place.

I just don't think it is a good idea for the Government to step in, plant A, B, and C, you burn coal; plant D, E, and F, you burn gas, and that type of activity—I think it is out of our purview.

Senator NICKLES. I appreciate it. Senator Ford.

Senator FORD. Thank you. It is in the greater interest of the country that we have all capabilities, and we not be limited, and I am not saying that you should or should not burn coal, but I think you should have the capability of doing that.

Mr. Secretary, a couple of quick questions about transportation. We are talking about natural gas and you alluded to the ability to transport. You have an open-access provision in your legislation. Around here, we call that mandatory contract carriage provision, but after having looked at your bill, I am a little bit in the posture of calling it passing the buck because of its lack of detail on how the program should work.

You mentioned FERC's order 436 a moment ago to Senator Domenici, I think, as it relates to their transportation program. Why isn't that 436 program sufficient?

Secretary HERRINGTON. Several things have happened since 436 came in. Not enough pipelines have signed up for 436. Only Columbia and Columbia Gulf have officially requested open access status. About 10 others have indicated an interest in signing up, but only after they obtain agreements from their customers to reduce the procompetitive conditions.

For up to 2 years, grandfather provisions will allow pipelines to continue to carry gas for others without offering nondiscriminatory transportation. I just don't think—I think the Commission's motives and efforts were good. I just don't think it has worked out the way it should have worked out.

Senator **Ford**. Mr. Secretary, are you personally aware of any instances in which an interstate pipeline has refused to transport natural gas?

Secretary **Herrington**. I would like to submit that answer for the record, if I could.

Senator **Ford**. I would like for you to be very specific. Does your staff with you know of any instances?

Secretary **Herrington**. I think we have some and we talked about them before coming here, but I would, rather than guess at that, I would like to be complete.

[The information follows:]

A number of instances of anticompetitive behavior by natural gas pipelines have been publicly reported. Some of these reported instances include:

- In September 1985, Southern California Gas Company reported that El Paso pipeline company, one of two interstate pipelines supplying SoCal Gas, was threatening to discontinue all transportation of spot market gas unless SoCal Gas agreed to purchase 1.2 billion cubic feet of system supply gas per day.
- In November 1985 after Order 436 took effect, a number of pipelines immediately suspended transportation of gas:
    - El Paso Natural Gas Company suspended 600 million cubic feet a day of spot market sales to customers in California and the Southwest.
    - Panhandle Eastern Corporation and its subsidiary Trunkline discontinued interruptible transport of gas to 85 users in five midwestern states, affecting sales of about 110 million cubic feet a day of gas.
    - Transcontinental Pipeline Company suspended transportation of 3 million cubic feet a day of gas to New Jersey Zinc Company. New Jersey Zinc was forced to shut down.
    - Southern Natural Gas Company suspended all transportation of spot market gas to Georgetown Steel Corporation, which had been able to reopen in 1985 by purchasing lower cost spot gas after being shut down for two years.

- On December 20, 1985, ANR pipeline company announced that it would discontinue all transportation services because it could not get its customers to agree to limit their use of transportation.

In addition to these examples, we received a number of other reports of anticompetitive behavior by interstate pipelines in the public comments to our report to Congress, Increasing Competition in the Natural Gas Market: The Second Report Required by Section 123 of the Natural Gas Policy Act of 1978. These comments are listed in Appendix B of that report. Both the report* and a copy of the Appendix are attached for the record.

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*The report has been retained in subcommittee files.

Appendix B

EXAMPLES OF ANTICOMPETITIVE BEHAVIOR IN GAS TRANSMISSION

The public comments to the Section 123 report reveal several examples of refusals to carry gas by gas transporters. These examples are described in detail below. Following these examples is a list of stated pipeline company policies regarding voluntary carriage that were provided in the public comments submitted collectively by the Aluminum Association, the American Iron and Steel Institute, the Georgia Industrial Group, and the Process Gas Consumers Group. These examples and policies show the great difficulties that producers and end-users often have in obtaining voluntary carriage.

EXAMPLES OF REFUSALS TO CARRY GAS[1]

The comments submitted by Ventura Resources, Inc., of Encino, California, are summarized here:

- Ventura owns a small gas field near Creek County, Oklahoma. The three wells on the field are capable of producing 800 to 1,100 thousand cubic feet of gas per day. The original well was completed based on the knowledge that a collection line owned by Transok Pipeline Company was within 2 miles of the well and that Ventura had received a favorable reaction to an initial telephone inquiry regarding the ability of Transok to purchase this gas. However, once the well was completed, Transok required Ventura to ship its gas through another line that required Ventura to install gathering lines and a compressor system. Ventura agreed, and a contract with a 75-percent take-or-pay provision was agreed to at a price of $2.25 per million Btu's. In 1983, after 6 months of "no take," Transok informed Ventura that their take would go down to 25 percent. Ventura then found a new buyer for the gas at a lower price. Transok refused to provide transportation services. Ventura was finally able to sell its gas to Transok at a reduced price, but only after obtaining the services of an independent broker who, through past connections, was able to negotiate a new contract with Transok. The broker received a continuing commission of $0.05 per thousand cubic feet for negotiating this contract.

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[1] In many cases, the firms involved consider these examples to be confidential business matters and therefore do not specifically identify the parties to these transactions.

The following examples were provided by the Aluminum Association et al.:

- In the course of more than a year of negotiations, an interstate pipeline company repeatedly found excuses for not transporting specific supplies of gas to a Midwestern company, despite proposals for gas to be delivered from various locations. The company recently announced that the relevant plant will be closed, putting 500 people out of work. The high cost of gas was a major contributing factor to the shutdown.

- A Midwestern manufacturer negotiated the purchase of self-help gas to replace an alternative fuel. The interstate pipeline company and local distribution company agreed to transport the gas for the manufacturer. After completing 1 year of the contract, the interstate pipeline company refused to continue the transportation on the grounds that the local distribution company was delivering gas to its industrial customers at a cost that was lower than the cost of the alternative fuel. This cost relationship between the local distribution company's delivered gas and the alternative fuel had existed from the initiation of the contracts. The interstate pipeline company had chosen to use this as a means of eliminating gas-on-gas competition.

- A major interstate pipeline company refused to transport self-help gas until a group of its largest industrial customers intervened in a rate case involving revised rate structures for industrial customers. Upon analysis of the industrial group's arguments based on cost-of-service principles, a settlement was agreed to that allowed transportation of a percentage of the gas requirement of the pipeline company's largest industrial customers.

- A major interstate pipeline company in the South has refused to transport gas that is from a major producing area to any customer not on its system, whether the customer is an intrastate or interstate end-user. This effectively eliminates a major low-cost gas-producing area from being available to off-system industrial consumers.

- An industrial user in the East found gas available for direct purchase from a producer, and its local distribution company agreed to transport the gas to the user's plant. Two of the interstate pipeline companies serving the area refused to carry the gas because the user could not certify it would displace an alternative fuel.

- Complaints have been filed with the Pennsylvania Public Utility Commission by local distribution companies to prevent industrial users from shifting to another utility for gas supply. With overlapping service areas between utility companies, this request would eliminate all gas-on-gas competition and force industrial customers into situations of being required to purchase gas at noncompetitive prices.

Finally, the National Council of Farmer Cooperatives provided the following comments:

- Pipelines currently carry gas for some users; but they all too often have exhibited a notable reluctance to do so. A number of the National Council's members have attempted to lower energy/feedstock costs by negotiating contract carriage rights with natural gas pipeline companies serving their geographic areas. In some instances, the pipeline company has made a good-faith effort to work with the end-users served by its system. Unfortunately, other pipelines have refused to consider contract carriage, even where surplus transmission capacity clearly existed.

STATED PIPELINE COMPANY POLICIES ON VOLUNTARY CARRIAGE

The following were provided in the public comments of the Aluminum Association *et al*.:

- Columbia Gas Transmission Corporation filed tariffs in 1983 that explicitly ban transportation for users whenever Columbia decides that the transported gas would compete with its own sales. Even if the gas displaces oil, Columbia requires the user to give Columbia's existing producer-suppliers a right of first refusal to replace the original seller. The lawfulness of these and other anticompetitive restrictions was challenged and remains pending, in Docket No. RP84-11, a year after the tariff sheets took effect. Columbia Gulf Transmission Company incorporates into its tariffs all of Columbia Gas' transportation restrictions.

- Transcontinental Gas Pipe Line Corporation (TRANSCO) submitted responses in a FERC proceeding (Docket No. RP83-137-000) stating that it will not transport gas for any end-user if that will compete with its own sales. Experience confirms that this is TRANSCO's policy.

- A witness for Tennessee Gas Pipeline Company testified in Docket No. RP82-125 that Tennessee will not transport gas sold by others if that would reduce its own sales.

- Texas Eastern Transmission Corporation has transportation tariffs applicable to end-users that limit such services to instances involving the displacement of oil. Texas Eastern's policy was partly a product of local distributors' desires for protection from competition. Although the reasonableness of that restriction was challenged well over a year ago (in Docket No. RP83-35-000), the issue is still pending at FERC.

- Montana Dakota Utilities Company's filed tariffs state as a condition of service that "gas transported hereunder shall not be used to displace volumes of gas that would otherwise be purchased from [MDU]"--that is, it will not transport gas that will compete with its own sales. FERC recently approved that tariff in Docket No. RP84-14-001, et al., over a major producer's objection to that limitation on competition.

- Panhandle Eastern Pipeline Company imposes, as a condition of transportation, a "bid-out" procedure that gives its existing producer-suppliers a right of first refusal to supplant another producer's sale upon matching the major contract items.

- United Gas Pipe Line Company refused to agree to nondiscriminatory transportation on behalf of users as part of a settlement that included transportation to displace oil for distributors, and FERC refused to correct that deficiency in Docket No. RP-82-57.

- Numerous local distribution companies also refuse to transport any gas except to displace alternative fuels, and they pressure pipeline companies in FERC proceedings and elsewhere to do the same.

Senator **Ford**. I think you are going to be hard put to find them.

Let's be specific, and I will ask one more question, Mr. Chairman—I know you are trying to move on; we also have a bill from this committee on the floor.

Your bill says that pipelines should transport gas unless they are incapable of rendering the service. Please explain what that means, Mr. Secretary.

Secretary **Herrington**. It shifts the burden to the transportation side to show they can't do it. And I think that is where the burden ought to be.

What it is, it is a tilt in favor of transportation.

Senator **Ford**. Well, the pipeline's full capacity is needed to meet its contractual obligations to an LDC. Would that mean its pipeline would be incapable of transporting the gas?

Secretary **Herrington**. Yes; I think so.

Senator **Ford**. All right, if the pipeline wants to use a certain amount of its capacity to refill its storage fields in the summer, could it be prevented from doing that if a customer wants carriage?

Secretary **Herrington**. I don't have an answer on that. That is a tough one. I think that is something that FERC would have to decide.

Senator **Ford**. Oh, you are going to give that one to FERC?

Secretary **Herrington**. I think so.

Senator **Ford**. Well, it is interfering in the orderly business procedures of a company—that bothers me just a little bit. What would happen to open access transportation if the pipeline develops physical capacity problems?

Secretary **Herrington**. You mean something like a restriction?

Senator **Ford**. Right.

Secretary **Herrington**. Then they can't transport. That is a very reasonable position. They haven't got capacity if there is a bottleneck in the transportation system and that bottleneck is full, it seems to me.

Senator **Ford**. You say FERC would have to make the decision, however. How soon would FERC have to act upon a request for transportation, and would a hearing be required?

Secretary **Herrington**. I don't think we have details on that. I think it should be a rapid procedure. It should be done in a timely manner. I would not like to see these kind of things drag on.

Senator **Ford**. I have a couple of other questions, Mr. Chairman, in this general area that I would like to nail down a little bit tighter, if I could. I will present those to the Secretary in writing. He always responds very quickly.

Senator **Nickles**. Senator Ford, thank you, very much.

I might ask a request of you—we have been tentatively notified by the Democratic cloakroom that there is a refusal to allow us to sit after the hour of 11:15.

I would hope that they wouldn't do that. We have a lot of witnesses from out of State that are here. If that does happen, it is my intention to convene the hearing——

Senator **Ford**. Mr. Chairman, I would like to claim my innocence. [General laughter.]

Senator **Nickles**. I assumed as much.

Senator **Ford**. You know who it is as well as I do.

Senator NICKLES. The Senator from Ohio has a witness here, from Toledo, and we also have individuals from Houston and San Antonio——

Senator FORD. The gentleman from Toledo may be taken to lunch. [General laughter.]

Senator NICKLES. It is my intention, and I will just tell those that are here that if that does happen, I will apogolize and regret—it has not happened in some time. We went in early today and that is unusual, but it is my intention that if we are denied approval to sit from 11:15, to reconvene at 12 noon, and to run the hearing from 12 to 2 o'clock, when the Senate is in recess.

Senator Domenici.

Senator DOMENICI. Mr. Chairman, let me just make one observation, but before I do that, let me just tell you and the witnesses that I have to go chair a subcommittee hearing on appropriations. Obviously, if you start at 12 again, I will try to join you for part of it.

Senator Ford, let me comment, and if Senator Warner would have been here, with reference to coal versus gas as it applies to the Fuel Use Act. It appears to me that the time is getting very close where we have to start working together and I want to say to you, with reference to some of our very serious nuclear problems, I have greatly appreciated the sensitivity that you have exhibited to the nuclear problems that we have in our uranium industry.

But I do sense that there is at least a slight change on the part of the coal producers of the country with reference to the Fuel Use Act, and I thank them for that. There is some indication that they may be saying, Fuel Use Act elimination even for new plants isn't all that bad, provided there is some kind of mandatory flexibility built into it from the offset, so that you wouldn't preclude coal being used, if and when the market dictated and the event occurred that dictated it.

We don't know exactly how to work that out because what does it mean——

Senator FORD. It is very simple, I would say to my good friend from New Mexico; just make the plants coal-capable.

Senator DOMENICI. I understand.

Senator FORD. That is all you have to do. I don't want to baseload gas—just to have the possibilities of using coal.

Senator DOMENICI. We are very aware of that.

Senator FORD. And I think you will find that when you get to that point, a great deal of concessions can be made and I am perfectly willing to work with you in the amenable manner we have always done.

Senator DOMENICI. I was just going to say to you, so that it is "coal-capable," that is very correct, and easy to say. We just want to make sure that it is just as easy to implement, and we have to find out what that means. As soon as we do, let me say, from my standpoint, I am surely willing to work with you and the other Senators.

Senator FORD. Baseloading plant is the only thing I am interested in, Senator, and if you can accommodate me on that—I haven't been for incremental pricing, and you know that and you know why we have it.

I think basically we can get along very, very well, but the baseload is my problem and I don't want to lay down any barriers to coal an that—you get to concession on industrial and some other things, and you get to the point where you give just as far as you can give, and then at some point you have to quit.

I will give you my bottom line today, if you want it.

Senator DOMENICI. Thank you, very much. I appreciate it and we will work with you. Thank you, Mr. Chairman.

Senator NICKLES. Thank you, very much. Mr. Secretary, thank you, for your appearance today.

Our next witness is Mary Bushnell, chairman of the Illinois Commerce Commission, from Springfield.

Ms. BUSHNELL. Thank you, Mr. Chairman.

Senator NICKLES. In deference to all of our witnesses, we are going to have a timeclock on and we will set that for 5 minutes, and we will go and do as many panelists as possible and hopefully, we will have permission to sit continuously.

STATEMENT OF MARY B. BUSHNELL, CHAIRMAN, ILLINOIS COMMERCE COMMISSION

Ms. BUSHNELL. Thank you. I am pleased to testify before you today. The Illinois Commerce Commission has actively participated in the struggle to bring out competition in the natural gas industry. I would like to submit my written testimony and ask that it may be part of the record.

Senator NICKLES. Surely.

Ms. BUSHNELL. The Illinois Commerce Commission regulates local gas distributors within the State. Illinois customers consume 1 trillion cubic feet of gas annually, about 6 percent of national consumption.

It is in the public interest that the ICC responds to the reforms suggested for the natural gas industry within S. 2285, because this bill contains all the elements we believe necessary to allow market forces to be implemented effectively.

The provision of S. 2285, which is the vital link between producing and consuming sectors, is nondiscriminatory access to transportation. Any reform lacking a strong carriage provision is inadequate to provide the benefits of a competitive market for natural gas.

We agree with Secretary Herrington that carriage is the issue.

The ICC has actively contributed to the FERC proceedings in rulemaking 85-1. The keystone of 436, which resulted from that rulemaking, is the provision that transportation of gas by pipelines be on a nondiscriminatory basis. Absent open-access pipeline companies can discriminate against residential and other local distribution customers because there are no alternatives readily available.

Open access will provide alternative supplies to those captive customers. Competition among suppliers to sell gas in those markets through the local distribution company will do far more to regulate price and demand than any regulatory body.

However, State commissions would be in a position to hold the LDC's responsible for their gas acquisition decisions if open access, with the resultant variety of suppliers were available. Two-thirds of the cost of an LDC are for gas costs over which state commissions currently have no control.

Similarly, open access gives the producer the protection of alternative buyers and protects the seller from being shut in or getting unfair prices.

Pipelines can benefit from open access because their basic business should be moving gas, for which they will continue to charge an equitable price. Increasing the amount of gas moved increases revenues.

The result of FERC's efforts in RM85-1 was order 436, which was issued October 9, 1985. It was FERC's intent under article 436 to give consumers access to competitively priced gas, through transportation. The FERC has been reluctant under current statutes to compel transportation.

The experience to date with order 436 has been disappointing. Many pipelines have refused to opt for order 436. In bargaining with customers on implementing, pipelines are forcing their customers to give up the rights provided under the very order 436, that they are trying to purchase gas from.

Only with all the rights of order 436 can consumers expect to reap the full benefits of the competitive natural gas market. Additionally, some pipelines have avoided accepting the order by negotiating with price-sensitive end users for transportation under traditional procedures provided under 7(c).

These limited agreements lessen the effectiveness of pipelines to provide nondiscriminatory transportation. The experience to date makes it clear that a legal obligation to provide transportation, as included in the administration's bill, would clearly enhance the competitiveness.

The Illinois Commerce Commission was an early advocate of mandatory contract carriage. We still believe that a legal obligation to provide transportation is beneficial.

Pipelines are public utilities which have used eminent domain to build their systems. It is fully appropriate that pipelines not be allowed to discriminate, to withhold from public use the very system that public action enabled them to develop in the first place.

The lack of open access transportation has had significant impacts on Illinois economy. Illinois, like other Midwestern States, is heavily dependent on industries, such as steel production, heavy equipment manufacturing, automotive parts manufacturing, and agriculture, which are in a constant struggle to remain price-competitive against foreign production.

These industries must continue to cut production costs to stay afloat amid growing foreign competition. Not to permit open access transportation for natural gas would push the production costs in the wrong direction.

Illinois recently enacted legislation permitting the formation of energy cooperatives to purchase bulk quantities of natural gas at competitive prices. The principal benefactor was perceived to be Illinois residential customers and Illinois farmers.

Community-formed natural gas purchasing co-ops were to be established to lower production costs. This strategy will be foiled unless there is exists an open access system.

The ICC expresses qualified support for the Department of Energy proposal to the FERC to raise old gas ceilings. Our comments in that docket acknowledged that potential supplies of old gas could be forever lost under current price ceilings. We also agreed that now is the appropriate time to remove those price ceilings, given the current weakness in energy prices.

Our concern in RM-86-3, includes the need for open access for old gas decontrol to be effective in trimming the price of high-cost gas. While the Illinois Commerce Commission has not had time to fully evaluate the provisions of decontrol of old gas, any bills discussed today must be recognized that old gas decontrol is an important part of the comprehensive program to remove regulation of natural gas markets, but to repeat—the transition would and should be orderly through a device such as block billing previously endorsed by the Illinois Commerce Commission.

Incremental pricing discriminatorily singles out some uses of natural gas and is inconsistent with the reliance on the competitive market forces and should be repealed.

In conclusion, it is timely to consider additional use of competitive forces to efficiently and equitably allocate natural gas supplies. The experience with partial wellhead decontrol on January 1, 1985, and the ability of pipeline customers to contract directly for natural gas supplies in the limited transportation programs to date has shown that increased reliance on competitive markets is not only feasible but required.

Since S. 2285 contains strong provisions in this area, it is this bill which the Illinois Commerce Commission believes best addresses the problems of the natural gas industry.

[The prepared statement of Ms. Bushnell follows:]

Testimony

of

Illinois Commerce Commission
Mary B. Bushnell
Chairman

before the

United States Senate
Subcommittee on Energy Regulation and Conservation
of the
Committee on Energy and Natural Resources

April 15, 1985

I appreciate the opportunity to discuss with you the reform of regulation of the natural gas industry. The Illinois Commerce Commission (ICC) has been an active participant in the struggle to allow competitive market forces to operate in the gas industry.

The Illinois Commerce Commission (ICC) regulates local gas distribution companies in Illinois. Illinois is a major consumer of natural gas -- ranking fourth in consumption and third in value of consumption among the states. Illinois consumes over one trillion cubic feet of gas annually, which is over six percent of national consumption. Illinois produces about one billion cubic feet of natural gas annually, which is 0.1 percent of the State's consumption. The perspective of the ICC is therefore that of a major consumer of natural gas. It is the view of this Commission that competitive market forces, where viable, can best protect the interests of Illinois consumers.

Reforms considered in the bills to be discussed today -- removal of old gas price ceilings, removal of Fuel Use Act restrictions, removal of incremental pricing provisions of Natural Gas Policy Act of 1978, and requiring nondiscriminatory transportation of natural gas -- are all steps toward a fully competitive national natural gas market, and steps which the ICC endorses as components of a comprehensive reform of the industry. Since S. 2285, contains all four elements, it is this bill which we prefer and endorse. The first element reduces regulatory induced production distortions. The second and third elements remove regulatory induced consumption distortions. The final proposal, nondiscriminatory transportation, is primary as it provides the vital link between the producing and consuming sectors of the industry. It is this element which I will discuss first.

NONDISCRIMINATORY ACCESS

Nondiscriminatory access to transportation is crucial to the reliance on competitive market forces to efficiently and equitably allocate natural gas. Without nondiscriminatory access, these benefits to all producers and consumers can be thwarted by interstate pipelines.

Pipelines are now able to withhold their essential facilities by refusing to provide transportation on a nondiscriminatory basis. A competitive market for the commodity natural gas must be predicated on the ability of producers and consumers to transfer the commodity -- to obtain transportation of natural gas from the wellhead to the burner tip. Any reform lacking a strong carriage provision is inadequate to provide the benefits of a competitive market for natural gas.

The Illinois Commerce Commission actively contributed in the Federal Energy Regulatory Commission (FERC) moves toward fundamental reform in the natural gas industry. In particular the ICC has been involved with the FERC's path breaking proceeding RM85-1, Regulation of Natural Gas Pipelines Under Partial Wellhead Decontrol. The keystone of that docket is the provision in Order 436 that transportation of gas by pipelines be on a nondiscriminatory basis. The ICC has strongly supported open access to transportation as the means of transmitting the benefits of a deregulated natural gas market to natural gas consumers.

Our comments in Phase I of the Notice of Inquiry in RM85-1 demonstrated that these benefits were being foreclosed under the discriminatory access provided by pipelines at that time. Pipelines were able to discriminatorily segment their markets and prevent low cost gas from reaching their core market customers.

o Open Access Benefits Consumers

Absent open access, residential customers and other local distribution company (LDC) customers can be discriminated against by pipelines because they lack alternatives and thus are captive. The most important benefit of open access is that it would provide alternative sources of supply to currently captive buyers. This would offer these buyers greater protection than if they had alternative fuel capability. Currently captive customers would have supply alternatives if they were provided access to producers either directly or through their local distribution company. Just as families who must buy milk for their children are protected from the discrimination of a grocer charging ten dollars a gallon for milk by the existence of other grocers competing for their business, residential customers with no viable alternative to gas would be protected from excessive gas prices by producers competing to sell gas to them through their LDC.

The protection against exploitation provided by access to other sellers is superior to relying on substitute products since substitute products only limit exploitation to the price at which the buyer would switch to those products. This switching price depends on the price of the substitute. A rise in the price of the substitute increases the exposure to exploitation. A rise in the price of oil and coal would reduce the protection currently provided customers with dual fuel capability.

Open access would make regulation more effective in protecting gas consumers by concentrating regulation on the pipeline activities where monopoly power results from technological factors -- i.e., the transportation of gas. A central premise of the Natural Gas Policy Act (NGPA) is that interstate pipelines need continued regulation. The gas acquisition policies of pipeline companies would be of less concern if open access were provided. A pipeline which attempted to benefit by paying inflated prices for gas to its affiliated producers would see its gas costs rise and would lose its market for gas supply. Large users and LDCs would buy gas directly from producers and rely on the pipeline only for transportation services. The variation in gas costs between pipelines clearly shows that current regulatory oversight is not sufficient to protect the core market from undesirable pipeline purchase practices. The discipline of the market under open access would provide that protection.

In times of abundant supply, as currently exists, consumers would benefit by lower prices. Gas that is shut in today would reach market under an open access system. Thus surpluses would be dissipated through ower prices increasing the amount of gas demanded. The increased throughput of pipelines would also indirectly lower gas prices as unit transportation costs decline with higher pipeline utilization.

Open access would also better protect captive customers when supplies tighten. Part of the shortages of the 1970s reflected the inability of interstate pipelines to compete with intrastate buyers because of price ceilings. However, lack of access for both pipelines and LDCs across systems exacerbated the problem by forcing some areas to place moratoriums on hookups for new customers and even closing schools for lack of gas supply at the same time gas was being used as boiler fuel in other areas. The current large differences in gas costs between pipelines is a manifestation of the lack of open access in the system today.

Another benefit of open access to consumers is that LDC customers can be better protected by their state public utility commission. Not only would LDCs be able to benefit by purchasing gas directly, but also state commissions would be in a position to hold the LDC responsible for its gas acquisition decisions. Currently, over two-thirds of the costs of an LDC are for gas costs over which the state commission has no control or oversight. Open access would give the LDC some control over these costs and the state commission the ability to oversee them.

- Open Access Provides Benefits to Producers

Producers are in the business of discovering and selling gas. Factors which muffle signals to them from the end-user market and prevent access to this market are not in their best interest. The current market structure does both. The ability of pipelines to segment their markets has impeded the transferring of end-user price signals to producers. If end users and LDCs were able to deal directly with the large numbers of producers, the market pricing signals would be clearly felt.

Producers also would not be faced with shut-in gas, particularly when such gas is priced substantially below the market. The lower prices which would occur at the city gate would increase demand both directly and indirectly through the lower pipeline transmission rates needed as a result of greater throughput.

Just as the option of alternative suppliers protects core markets from the exploitation of the pipeline as a gas supplier, the option of alternative buyers protects producers from the exploitation of the pipeline as a gas buyer. One of the biggest benefits of the protection provided producers by open access would be that producers would no longer need the protection of inflexible long term contracts. Long term contracts have caused problems since they have resulted in prices and conditions of supply which have not been responsive to changing market conditions. Under the current situation of foreclosed access, a producer has little bargaining power upon expiration of his original contract.

Most of his costs are literally "sunk in the well", and he faces a single pipeline buyer. The producer is now a captive of the pipeline as the only buyer for its gas, just as the "core" customer through its LDC is a captive of the pipeline as a sole supplier. Without access, a producer needs the protection of a long term contract. Open access would protect the producer since the many possible buyers of the gas would assure the producer a fair price.

o Open Access Benefits to Pipelines

While pipelines would lose the discretion which their monopoly over gas supply currently allows, pipelines would also benefit through increased opportunities. A pipeline's basic business is moving gas. Open access provides the opportunity for increased throughput as the end-user market grows in response to lower prices.

Open access is in a pipeline's long term interest. Since pipeline assets have relatively long lifetimes, it is not in a pipeline's long term interest to pursue policies which maintain high prices to core markets. Such prices provide incentives to core customers to pursue actions which result in permanent load loss. While economically justified conservation is beneficial to the nation, uneconomic conservation caused by excessive gas prices is not beneficial to the nation and certainly not to the pipelines.

Finally, open access would provide increased access for a pipeline to low-cost supplies. A pipeline would not be obliged to limit its producer suppliers to those producers in its own geographic area.

o Experiences with Order 436

The result of the FERC's efforts in RM85-1 was Order 436 which was issued on October 9, 1985. It was FERC's intent under Order 436 to give consumers access to competitively priced gas through transportation. The FERC has been reluctant under current statutes to compel transportation. The experience to date with Order 436 has been disappointing. Pipelines have refused to opt for Order 436. In bargaining with customers on implementing Order 436, pipelines are forcing their customers to give up rights provided under the Order. Only with all the rights of Order 436 can consumers expect to reap the full benefits of a competitive natural gas market. Additionally, some pipelines have avoided accepting Order 436 by negotiating with price sensitive end users for transportation under traditional procedures provided under the Natural Gas Act Section 7(c). These limited agreements lessen the incentives of pipelines to provide nondiscriminatory transportation under Order 436. The experience of Order 436 to date makes it clear that the legal obligation to provide transportation as is included in the Administration bill would clearly enhance the competitiveness of the natural gas market.

The Illinois Commerce Commission was an early advocate of mandatory contract carriage. We still believe that a legal obligation to provide nondiscriminatory transportation is beneficial. Pipelines are public utilities which have used eminent domain to build their systems. It is fully appropriate that pipelines not be allowed to discriminately withhold from public use the very system that public action enabled them to develop in the first place.

The lack of open access transportation has had significant impacts on the Illinois economy. Industrial customers losing access to transportation recently saw a 45 percent increase in gas costs in the face of generally falling energy prices. Illinois like other Midwestern states is heavily dependent on industries such as steel production, heavy equipment manufacturing, automotive parts manufacturing, and agriculture, among others, which are in a constant struggle to remain price competitive with foreign production. These industries must continue to cut production costs to stay afloat amidst growing foreign competition. Not to permit open access transportation for natural gas will push production costs in the wrong direction. Any decline in the amount of Illinois goods produced will have an obvious rippling effect throughout Illinois and the nation as a whole.

Illinois recently enacted legislation permitting the formation of energy cooperatives to purchase bulk quantities of natural gas at competitive prices. The principal benefactor was perceived to be the Illinois farmer. Community-formed natural gas purchasing co-ops were to be established to lower farmers' production costs. This strategy will be foiled unless there exists an open access system.

Illinois has transportation tariffs in effect for all its major gas distribution utilities. Our local distributors are ready to move gas from the pipeline's city gate to the burner tip. However, unless pipelines provide transportation, gas cannot be moved. Additionally, small users in Illinois buying gas from their local distribution company are prevented from receiving the benefits of competition at the wellhead if their local distribution companies are foreclosed the opportunity to buy gas directly and have it transported for system supply. Open access to transportation is therefore critical to the welfare of large and small gas customers alike in Illinois and the nation as a whole.

Nondiscriminatory access to transportation must be part of any reform of regulation of the natural gas industry.

OLD GAS PRICE CEILINGS

The ICC expressed qualified support for the Department of Energy (DOE) proposal to the FERC (Docket RM86-3) to raise old gas ceilings.

Our comments in that docket acknowledged that potential supplies of old gas could be forever lost under current price ceilings for old gas. We also agreed that now is an opportune time to remove price ceilings on old gas given the current weakness in energy prices.

Our concerns with the DOE proposal in RM86-3 included the need for open access for old gas decontrol to be effective in trimming the price of high-cost gas. We continue to support block-billing as a transitory device to provide clearer price signals. The decontrol bills discussed here which do not include renegotiation provisions for old gas contracts address another of our concerns in RM86-3. The elimination of ceiling prices provided in the bills here, rather than higher ceiling prices and incentive prices provided in the DOE proposal in RM86-3, are beneficial.

While the Illinois Commerce Commission has not had time to fully evaluate the provisions on decontrol of old gas in the bills discussed today, it must be recognized that old gas decontrol is an important part of a comprehensive program to reform regulation of natural gas markets, but to repeat, the transition would and should be orderly through a devise such as the block-billing provisions previously endorsed by the Illinois Commerce Commission.

FUEL USE ACT

At the time the 1978 Powerplant and Industrial Fuel Use Act was passed, gas supplies were insufficient and were perceived to be in a long-term shortage situation. Federal regulation had depressed gas prices below market clearing levels for a considerable period of time, resulting in a shortage in gas supply. At the present time, more competitive conditions have been instilled in the natural gas industry. In a competitive market, restrictions on demand are unnecessary and, indeed, counter-productive because the market determines the price of a commodity, balancing supplies and the demands put on them.

The Fuel Use Act can prevent industrial firms and electric utilities from using the most efficient fuel. Therefore, the inefficient use of alternate fuels may be encouraged. This inefficiency has resulted in increased costs to customers -- costs of both a monetary nature and an environmental one. The higher costs of constructing plants using alternative fuels and the greater pollution problems of these plants warrant the repeal of the Fuel Use Act.

INCREMENTAL PRICING

The incremental pricing provisions of the Natural Gas Policy Act were also designed in a period of shortages and below market priced gas to protect high-priority users of natural gas by allocating the high costs of certain categories of new gas and imported gas to large industrial customers which use gas for boiler fuel. The current time period is one of surplus supplies and burner tip prices above free market levels. Whatever rationale once existed for a subsidy no longer exists. More competitive forces are present in the gas industry, and there is not the radical difference between the incremental ceiling prices and the distribution company system costs as existed in the past. Since current low alternative fuel costs make incremental pricing payments low, they can be removed with little effect on other customers. This makes it an opportune time to eliminate incremental pricing.

It is clear that the incremental pricing provisions are inconsistent with a reliance on a competitive market. The mechanics of incremental pricing also causes inefficiencies. In Illinois one distribution company recently lost a major customer as a result of the incremental pricing surcharge. This hurts other customers by leaving those customers to pick up the margin formerly paid by the customer subject to incremental pricing. These provisions also encourage the inefficient use of alternate fuels while unused low-cost supplies of natural gas are available for consumption.

It is discriminatory to these large industrial customers to segment them and require them to subsidize other customers. These industrial firms must compete in a world market to sell their products. Additional costs placed upon them by their local distribution companies inhibit their ability to compete, and jeopardize the jobs which are held by the very class of customers the incremental pricing provisions were designed to protect.

Incremental pricing is inconsistent with relying on a competitive market for natural gas and will reduce the benefits which could otherwise be obtained from a competitive natural gas market. Incremental pricing provisions should be repealed.

CONCLUSION

It is timely to consider additional use of competitive forces to efficiently and equitably allocate natural gas supplies. The experience with partial wellhead decontrol on January 1, 1985 and the ability of pipeline customers to contract directly for natural gas supplies in the limited transportation programs to date has shown that increased reliance on competitive markets is not only feasible but also is required. It is required to provide the American public with the lowest prices consistent with adequate long term supplies of this vital commodity.

Open access to transportation is the fundamental reform needed. In conjunction with a strong carriage statute; old gas decontrol, repeal of the Fuel Use Act, and repeal of incremental pricing offer substantial additional benefits. However, we caution that without nondiscriminatory access the benefits of these other reforms will be substantially reduced and indeed may not be justified. Since S. 2285 contains strong provisions in this area, it is this bill which the Illinois Commerce Commission which best addresses the problems of the natural gas industry.

Senator **Nickles**. Thank you, very much. One quick question. You emphasize access and your desire for access; do you feel like it would be most important for us in any bill that we have to have an access provision, contract carriage provision in any gas bill?

Ms. **Bushnell**. Yes.

Senator **Nickles**. Senator Ford.

Senator **Ford**. Let me, Madam Chairman, ask you a question or two. You said you are for decontrol of old gas, but you haven't studied the impact of that. How could you make a decision for decontrol of old gas before you have studied the impact it might have on the consumer?

I think that is the way I understood your statement.

Ms. **Bushnell**. We believe as a commission—and it is not only my personal belief—that if old gas is not decontrolled in some sort of orderly manner, through legislation, and if there isn't open transport, we will never get to market clearing levels. It is an artificial device.

At the time when you have the greatest supply of natural gas, we have the highest prices and that exists because of regulatory constraints on the part of FERC and on the part of Congress, which limits old gas from rising, new gas from falling. I think you either believe in basic economics or you don't believe in it, and I find that consumers believe that they are paying too much for a product and they do not have the ability to buy it at a lower price.

Most of that hinges on transportation.

Senator **Ford**. Well, when the prices are high, we hear a lot of wailing and gnashing of teeth for us to come and reduce the prices. When prices are down, we hear just the opposite. We are in a catch 22.

Now, you represent the Commerce Commission and that does not necessarily mean a public utility commission.

Ms. **Bushnell**. It is the public utility commission.

Senator **Ford**. You authorize the construction of new utilities in your State?

Ms. **Bushnell**. We give certificates of necessity and convenience.

Senator **Ford**. So then that approves the construction.

Ms. **Bushnell**. Not necessarily.

Senator **Ford**. What does it do?

Ms. **Bushnell**. It gives them the ability to construct; it doesn't mean that we approve. [General laughter.]

We are having some difficulties in the state over that question, let me tell you.

Senator **Ford**. Well, I don't blame them. [General laughter.]

I want to tell you, women throw me.

Ms. **Bushnell**. It is not a feminist issue, Senator.

Senator **Ford**. I like it.

But let me ask you then, on your certificate of convenience and necessity, what would you put in that certificate today as the fuel to generate?

Ms. **Bushnell**. We have a very large coal economy in the State of Illinois, also, Senator, and we have made public statements in the past, and will in the future, that Illinois coal is a very important commodity. I would like to see our utilities use coal as part of the mix of their generation capabilities.

Senator FORD. May I put it in a little different language for you; that you would say before you would certificate, that the utilities should have coal capability?

Ms. BUSHNELL. We would certain consider that. We are a long way from anything ever coming up before the commission where excess capacity is extreme at this point. But we are interested in that, in a proper mix, and it may well be that in the future, as we look at plans for public utilities within the State of Illinois that we suggest that there be dual fuel capability, and that wouldn't be just oil.

Senator FORD. You are just saying it may be and you could do that.

Ms. BUSHNELL. I may not be there.

Senator FORD. Well, I may not be here either.

Ms. BUSHNELL. But the policy is certainly to encourage the use of Illinois coal within the State of Illinois, both on the part of the Governor and on the part of the Commerce Commission.

Senator FORD. You may find you will be getting Columbian coal before long.

Nevertheless, I think that emphasis is coal-capable; that would be your emphasis? That is what you are trying to indicate?

Ms. BUSHNELL. That is what I am trying to indicate.

Senator FORD. I understand that. Thank you, Mr. Chairman.

Senator NICKLES. Senator Ford, thank you, very much. Senator Metzenbaum.

Senator METZENBAUM. Mr. Chairman, I am not going to have any questions for this witness, but I would preface my comments by saying I certainly would totally agree with one part of your comment, and that is whether you decontrol the price of natural gas or not, it is hardly a sexist issue.

I have difficulty in understanding how come my colleague would refer to the fact that he has difficulty understanding women. I am going to take it up with Mrs. Ford.

Senator FORD. I didn't say that. I understand women very well. We have a Governor of Kentucky who is a woman and I supported her very much, so you be sure that when you quote you think I said, you say it so I can rebut it, will you please? [General laughter.]

Senator METZENBAUM. I thought I got——

Senator FORD. No, no. No, no. There is no implication there. She is reflecting the Commission's opinion and she said not only Commission, but her opinion, and I honored that. I didn't say anything—don't get me in that box, friend.

And I am beginning to wonder about friendship here. [General laughter.]

Senator METZENBAUM. Having said that, I have, over a period of time, certainly had much concern about the issue of deregulation. I think actually before you came to the Senate, Senator Nickles, and if there is to be legislation that is to be moved on this subject, I will be able to give more attention and time to the subject than I am able to give this morning.

Unless somebody can give me overwhelming, convincing evidence that the price will—that prices for the consumer won't go up if you have decontrol, I would again be very much opposed to decontrol.

But I don't think that is any great surprise to my colleague, the Chairman, and I am going to leave for another committee.

Does the Chairman intend to move a bill on this subject?

Senator NICKLES. The Senator is correct. Just to further answer the statement—you might excuse us, Madam Chairman—but, earlier today, myself and other people, indicated our desire to move legislation this year. There is a question of how comprehensive it would be.

It is my intention to move whatever we can get, whether that is Fuel Use Act repeal, modifications, incremental pricing; whether it deals with a carriage provision still remains to be seen. This committee debated for about 2½ months on carriage.

The Secretary's carriage proposal, I might mention, is two pages, whereas the committee will remember quite well, we debated carriage for a long time and ended up with a very complicated and I am not sure if it was a real workable carriage provision back a couple of years ago. But, anyway, how comprehensive the bill would be remains to be seen, but it is our hope that we will be able to move some positive natural gas legislation this year.

Senator METZENBAUM. I want to point out that I think there is something ironic about the fact that those who are pushing for decontrol are also begging for price supports for domestic oil through import taxes. In one instances, you want the Government out of the arena and in other instance you want the Government very much in the arena.

I understand the problems in the oil industry and the natural gas industry, but I think that you do have that contradiction among some of you who are looking for relief, and I understand that, but the point is, I don't think it is a logical position.

I think the industry also has to recognize that decontrol, I don't believe, will happen unless it is tied to bringing all high-price gas down to market levels. I think that there are those who would strongly oppose that for very obvious economic reasons.

Senator NICKLES. I might tell the Senator, too, because you missed Secretary Herrington's comments—his proposal did not have abbrogation of contracts on either the low side or the high side—just to let you be aware of that.

We worked with the Senator from Ohio in the past, and made some progress, although we were not able to pass a bill in the final outcome. I am sure that you will be an active participant in the legislation that we work on this year, as well.

Senator METZENBAUM. I have been recently; I am looking forward to it.

Senator NICKLES. I am sure that is the case.

Senator FORD. Let me ask a question?

Senator NICKLES. Surely.

Senator FORD. In the witness list here, I just glanced over it—we would not receive someone before the committee today who would be able to give me this answer, I think.

Would there be a different depreciation schedule for a utility for different types of fuel?

Ms. BUSHNELL. I am not sure. I would be glad to answer your question in more detail. Depreciation schedules, in what way? Do you mean accounting for the Internal Revenue Service, or coming before the Commission on rate of return?

Senator **Ford**. Well, I think coming before the Commission on rate of return, because it would be my judgment that oil and natural gas probably would expect and need a faster depreciation than, say, coal would be. Coal would be a longer period of time when you begin to factor in a 30-year period.

Ms. **Bushnell**. I think that is the company's choice. They are now factoring in 35 years on a nuclear facility, and we have not seen one that lasts that long. We have certainly seen coal plants last that long, and we have also seen coal plants who might be—that could be reactivated with some additional capital costs, or their life lengthened. There is interest on the part of the Commission in seeing that that happens in certain facilities.

Senator **Nickles**. Senator Ford, we have been notified that we do not have permission to sit. It is my intention to reconvene the hearing at 12 noon.

Wait a minute.

[Pause.]

Senator **Nickles**. We are going to go on some other information. We are going to continue hearing until we hear outright objection. I have the Republicans saying we don't have permission, and the Democrats saying we do have permission. The Republicans are saying the Democrats are objecting to us meeting. That is an interesting——

Senator **Ford**. Mr. Chairman, could I balance my statement to say that I can no more understand men than I can understand women?

Ms. **Bushnell**. Thank you, Senator. [General laughter.]

That almost makes up for that.

Senator **Ford**. I am trying my best to get out of this. [General laughter.]

It was my grammar that is bad.

Senator **Nickles**. Ms. Bushnell, thank you very much for your appearance before the committee today.

If our next panel would please come forward.

To our panelists, I appreciate your interest, and we will have to ask if you will keep your remarks within 5 minutes; that might make it possible for us to proceed to the next couple large panels.

Our first panelist we have is Mr. R.F. Nelson, who is general manager of natural gas for Shell Oil Co., Houston, TX, representing the Natural Gas Supply Association. Mr. Nelson.

STATEMENT OF R.F. NELSON, GENERAL MANAGER, NATURAL GAS, SHELL OIL CO., ON BEHALF OF THE NATURAL GAS SUPPLY ASSOCIATION

Mr. **Nelson**. Mr. Chairman, as you mentioned, I represent the Natural Gas Supply Association; 90 percent of the Nation's gas supply comes from NGSA members.

With your permission, Mr. Chairman, I will ask my complete testimony be entered in the record, and I will briefly summarize my remarks.

Senator **Nickles**. Thank you, very much.

Mr. **Nelson**. What can be done to assure domestic supply of market-sensitive gas? One, total deregulation of natural gas prices at the wellhead; two, nondiscriminate transportation of gas to markets; and, three, the end of all artificial restrictions in the end-use of natural gas, repeal for decontrol in the broadest sense and a comprehensive solution to the problems caused from years of Government tinkering with our natural gas marketplace.

Mr. Chairman, there remain no reasons to continue this mischievous price controls on natural gas. Deregulation of oil and the partial deregulation of natural gas have already made the consumer a clear winner. Why not go ahead and help them some more? There is no better time than now.

The second key problem is transportation. The response to FERC orders 436 and 436(a) has shown that the pipeline segment of the industry is reluctant to provide transportation on a voluntary basis.

The footdragging by the pipelines is denying the benefits of competition to the country.

Third, markets for natural gas would be helped by repeal of the Fuel Act and the Fuel Use Act and the incremental pricing provisions of the Natural Gas Policy Act. The bill proposed by Secretary Herrington last week constructively addresses the Nation's gas problems, as does your bill, Mr. Chairman, S. 1302.

The producing industry is not so much concerned about exactly how these ills are treated, but we stand united in our feeling that our Government must cure the gas mess in this country once and for all.

Pipeline and distributor groups want to extract a price for decontrol. They want the massive abbrogation of contracts. Mr. Chairman, I can give you a long list of extremely low-priced contracts that producers have and are honoring, and I can relate court cases that have, in a word, "stuck" low prices to the producer. We have lived with this and will continue to do so. Producers intend to honor our contracts whether the price is low or high.

Now come our pipeline purchasers when fuel prices are too high, to tell you that legislative relief is needed to resolve take-or-pay liabilities. In my view, the record is beautifully clear: contract differences are rapidly evaporating. In fact, a NGSA survey of 15 major producers reveal that $8.3 billion in most new take-or-pay liabilities accumulated from 1981 to 1985; $5.8 billion are gone; 70 percent of the problems have been solved by give and take.

The take-or-pay conversations of recent vintage will also probably creep silently away. As was the case in prior years, only a handful of pipelines actually have a problem, that is if you are inclined to believe their annual reports.

Mr. Chairman, while the natural gas industry has and can resolve the contractual problems related to take-or-pay, the Government must help resolve the other problems I have described. Wellhead prices must be totally decontrolled; nondiscriminatory access to transportation must be provided, and constraints to end uses of natural gas must be removed. Only then can our industry be responsive and competitive in today's marketplace.

Consumers will then enjoy equitable prices and a very significant improvement in future supplies in all areas of the Nation. Thank you.

[The prepared statement of Mr. Nelson follows; the appendixes attached to the statement have been retained in subcommittee files.]

TESTIMONY

OF

R. F. NELSON

FOR THE

NATURAL GAS SUPPLY ASSOCIATION
(NGSA)

BEFORE THE

UNITED STATES SENATE

SUBCOMMITTEE ON ENERGY REGULATION & CONSERVATION

COMMITTEE ON ENERGY & NATURAL RESOURCES

ON

TUESDAY, APRIL 15, 1986

GOOD MORNING, MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE. MY NAME IS DICK NELSON. I AM THE GENERAL MANAGER, NATURAL GAS, FOR SHELL OIL COMPANY, BASED IN HOUSTON, TEXAS.

I AM APPEARING BEFORE YOU TODAY AS CHAIRMAN OF THE STEERING COMMITTEE OF THE NATURAL GAS SUPPLY ASSOCIATION (N-G-S-A). N-G-S-A IS A NATIONAL ORGANIZATION WHICH REPRESENTS DOMESTIC PRODUCERS OF NATURAL GAS ON LEGISLATIVE AND REGULATORY ISSUES AT THE FEDERAL LEVEL. THE INDEPENDENT AND INTEGRATED NATURAL GAS PRODUCTION COMPANIES WHICH ARE MEMBERS OF N-G-S-A MARKET ROUGHLY NINETY PERCENT OF AMERICA'S NATURAL GAS PRODUCTION.

N-G-S-A'S MEMBERS ARE COMMITTED TO THE CONCEPT OF FREEING NATURAL GAS MARKETS, AT THE WELLHEAD AND AT THE BURNERTIP, FROM GOVERNMENT INTERFERENCE IN THE FORM OF FEDERAL REGULATION. DURING THE PAST FORTY YEARS THE NATURAL GAS INDUSTRY HAS BEEN SUBJECTED TO CONSIDERABLE POLITICAL

TINKERING TO ESTABLISH OR PRESERVE ECONOMIC BENEFITS FOR CERTAIN INTEREST GROUPS. REGIONAL POLITICAL CONSIDERATIONS HAVE DOMINATED OVER SOUND POLICY DECISIONS BASED ON THE PRINCIPLES OF SUPPLY AND DEMAND. EVEN TODAY, CONTINUING GOVERNMENT REGULATION OF NATURAL GAS PRIMARILY BENEFITS A SMALL GROUP OF CONSUMERS AT THE EXPENSE OF OTHER SIMILARLY SITUATED CONSUMERS AND THE ECONOMY AS A WHOLE.

NO SEGMENT OF THE ENERGY INDUSTRY HAS SUFFERED MORE FROM NATIONAL ENERGY AND ECONOMIC POLICIES BASED ON FLAWED POLITICAL ASSUMPTIONS, THAN HAS THE NATURAL GAS INDUSTRY. AFTER NEARLY A HALF CENTURY OF PRICE CONTROLS AND TIGHT REGULATIONS OVER INTERSTATE GAS SUPPLIES AND SALES, THE INEVITABLE OCCURRED IN THE LATE SEVENTIES WHEN THE NATION EXPERIENCED SEVERE NATURAL GAS SHORTAGES. THE HISTORICAL PROMISE HELD OUT TO CONSUMERS THAT NATURAL GAS SUPPLIES WOULD ALWAYS BE PLENTIFUL AND CHEAP IF CLOSELY REGULATED IN PRICE, WAS PROVEN TO BE A CRUEL HOAX.

INDEED, IN A STUDY RELEASED IN FEBRUARY OF THIS YEAR, THE ENERGY INFORMATION ADMINISTRATION (E-I-A) STATES THAT PRIOR TO PASSAGE OF THE NATURAL GAS POLICY ACT IN 1978

(N-G-P-A), "THE YEARS OF WELLHEAD REGULATION HAD RESULTED IN INDUSTRY CHAOS: SHORTAGES OF SUPPLY IN THE REGULATED INTERSTATE MARKET, SURPLUS IN THE UNREGULATED INTRASTATE MARKET, AND PRICES THAT HAD NO RELATION TO THE CURRENT MARKET VALUE OF NATURAL GAS."*

THE NATURAL GAS POLICY ACT REPRESENTED A NECESSARILY DIFFICULT COMPROMISE. BY CREATING MANY NEW DISTORTIONS IN GAS MARKETS THAT HAVE BEEN HARMFUL IN RECENT YEARS, THE N-G-P-A CONTINUED MANY OF THE FLAWED POLICIES OF THE PAST. BUT THE N-G-P-A DID PROVIDE FOR THE PARTIAL DEREGULATION OF NATURAL GAS AT THE WELLHEAD ON JANUARY 1, 1985. PARTIAL DEREGULATION, COUPLED WITH RECENT FALLING OIL PRICES, SET IN MOTION A COMPETITIVE ENVIRONMENT IN THE NATURAL GAS INDUSTRY WHICH HAS SPREAD AND INTENSIFIED SINCE JANUARY OF LAST YEAR.

SPOT MARKET PRICES FOR NATURAL GAS AT THE WELLHEAD HAVE FALLEN STEADILY SINCE SEPTEMBER, 1984. THOSE WHO OPPOSE THE LOGICAL FINAL STEP OF REMOVING THE REMAINING WELLHEAD

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* "AN ANALYSIS OF NATURAL GAS CONTRACTS," ENERGY INFORMATION ADMINISTRATION (VOL. I, FEBRUARY 1986).

CONTROLS EXHIBIT A FUNDAMENTAL DISTRUST OF MARKET MECHANISMS AS WELL AS A SHORT-SIGHTED VIEW OF THE PUBLIC INTEREST. IN THE E-I-A REPORT WHICH I CITED EARLIER, IT IS NOTED THAT ALTERNATING PERIODS OF SURPLUS AND SHORTAGE HAVE BEEN MET BY COUNTERPRODUCTIVE F-E-R-C REGULATIONS "CAUSING DISORDERS OF ONE KIND IN TIMES OF SURPLUS AND DISORDERS OF ANOTHER KIND IN TIMES OF SHORTAGE. FEDERAL POLICY HAS SHIFTED ACCORDINGLY, BUT TO DATE UNSUCCESSFULLY."*

OPPONENTS OF COMPLETE WELLHEAD DEREGULATION WANT TO MAINTAIN THE CUMBERSOME AND BUREAUCRATIC REGULATORY REGIME WHICH THEY BELIEVE IS APPROPRIATE TO CURRENT CONDITIONS OF SURPLUS, WITHOUT REGARD TO THE NEEDS OF A HEALTHY ENERGY INDUSTRY, OR FOR SECURE NATURAL GAS SUPPLIES. ALTHOUGH PURPORTEDLY CLAIMING TO SUPPORT THE INTERESTS OF CONSUMERS, OPPONENTS OF DEREGULATION WOULD, IN FACT, DENY CONSUMERS THE SIGNIFICANT BENEFITS WHICH WOULD ACCRUE FROM A COMPETITIVE AND ECONOMICALLY RATIONAL PRICING STRUCTURE.

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* ID. AT 33.

N-G-S-A STRONGLY SUPPORTS THE COMPLETE DEREGULATION OF ALL NATURAL GAS SUPPLIES AT THE WELLHEAD. N-G-S-A ALSO FAVORS LEGISLATIVE PROVISIONS WHICH WILL SERVE TO PERMIT PRODUCERS AND CONSUMERS TO PROCURE TRANSPORTATION OF NATURAL GAS ON A NON-DISCRIMINATORY BASIS. N-G-S-A HAS ALWAYS OPPOSED RESTRICTIONS ON NATURAL GAS USE, AND, THEREFORE, STRONGLY SUPPORTS LEGISLATION REPEALING THE FUEL USE ACT AND INCREMENTAL PRICING PROVISIONS OF THE N-G-P-A.

TODAY WE FACE THE INEVITABLE CONSEQUENCE OF A MASSIVE DOWNTURN IN EXPLORATION AND DRILLING FOR NEW RESERVES. N-G-S-A HAS DETAILED DECLINING DRILLING LEVELS BEFORE THIS COMMITTEE IN PRIOR TESTIMONY ON NOVEMBER 21 AND SEPTEMBER 19, 1985. WITH THE CURRENT DECREASE IN INTERNATIONAL ENERGY PRICES THE PROSPECTS FOR DISCOVERY AND DEVELOPMENT OF NEW AND EXISTING RESERVES HAVE DIMINISHED SIGNIFICANTLY. IT IS THEREFORE IMPERATIVE THAT IMPEDIMENTS TO DEVELOPMENT OF LEAST COST RESERVES AND THE MARKETING OF THOSE RESERVES BE REMOVED.

A QUICK OR A PARTIAL FIX WILL NOT SERVE THE BEST INTERESTS OF THE INDUSTRY OR CONSUMERS. NOW IS THE TIME FOR THE FEDERAL GOVERNMENT TO FULLY WITHDRAW FROM THE BUSINESS OF

REGULATING NATURAL GAS PRODUCERS. A SIGNAL NEEDS TO BE SENT TO ALL SEGMENTS OF THE INDUSTRY -- PRODUCERS, PIPELINES, DISTRIBUTORS AND CONSUMERS ALIKE -- THAT A FREE MARKET AND PRIVATE NEGOTIATIONS THEREIN REPRESENT THE BEST TOOLS FOR ACHIEVING A REASONABLE BALANCE IN SUPPLY AND DEMAND AT A FAIR PRICE.

IN ADDITION TO OUR SUPPORT FOR REPEAL OF THE FUEL USE ACT AND INCREMENTAL PRICING PROVISIONS OF THE N-G-P-A, WE ENDORSE THE NATIONAL DEFENSE COUNCIL'S OPPOSITION TO A CONGRESSIONAL REQUIREMENT THAT THE DEPARTMENT OF DEFENSE IS PROHIBITED FROM USING NATURAL GAS IN NEW, LARGE HEATING SYSTEMS ON MILITARY INSTALLATIONS WITHIN THE CONTINENTAL UNITED STATES, REGARDLESS OF THE COST OR ENVIRONMENTAL BENEFITS OF USING GAS.

MR. CHAIRMAN, WE UNDERSTAND DISTRIBUTORS AND PIPELINES MAY ANNOUNCE SOON THEIR WILLINGNESS TO ENDORSE PHASED DEREGULATION OF OLD GAS, SIMILAR TO THE APPROACH IN YOUR LEGISLATION IN RETURN FOR INSERTION OF A MARKET-OUT OR ECONOMIC REDETERMINATION CLAUSE -- CALL IT WHAT YOU WILL -- IN ALL CONTRACTS THAT THEY DESCRIBE AS NON-MARKET

RESPONSIVE. PIPELINES SEEM TO BE INCREASINGLY RELIANT UPON THE MARKET-OUT MECHANISM AS A MARGIN ENHANCEMENT TOOL.

BASICALLY, WHAT THIS PROPOSAL WOULD DO IS HONOR CONTRACT SANCTITY FOR THOSE CONTRACTS REGULATED AT PRICES WELL BELOW THE MARKET, FREEING SOME OF THAT GAS AT A RATE OF ABOUT 8 TO 9 PERCENT PER YEAR, WHILE IN RETURN GIVING PIPELINES THE ABILITY TO UNILATERALLY ABROGATE IMMEDIATELY ALL CONTRACTS THAT ARE CONSIDERED ABOVE WHAT THEY DEFINE AS MARKET. THE REVENUE IMPACT IF SUCH A PROPOSAL WERE ADOPTED WOULD BE ENORMOUS FOR THE DOMESTIC PRODUCING INDUSTRY WHICH IS ALREADY SUFFERING FROM SERIOUS PROBLEMS. THE IMPACT UPON GAS SUPPLIES WOULD ALSO BE VERY NEGATIVE.

BEFORE I CLOSE, MR. CHAIRMAN, I WOULD LIKE TO ADDRESS THIS CONTRACT ABROGATION ISSUE WHICH HAS GENERATED CONSIDERABLE DEBATE OVER THE COURSE OF THE PAST FOUR YEARS. IN CURRENT PROCEEDINGS BEFORE THE FEDERAL ENERGY REGULATORY COMMISSION (F-E-R-C), SOME PIPELINES AND DISTRIBUTORS ARE ARGUING THAT A SERIOUS PROBLEM IS BREWING IN THE FORM OF PIPELINE CONTRACTUAL TAKE-OR-PAY OBLIGATIONS. IN F-E-R-C DOCKET NO. RM86-3-000, N-G-S-A HAS SUBMITTED TWO SETS OF

COMMENTS WHICH ARE ATTACHED TO MY FORMAL REMARKS AS APPENDICES A & B AND I REQUEST THAT THEY BE MADE A PART OF RECORD OF THESE PROCEEDINGS. N-G-S-A'S COMMENTS IN APPENDIX B INCLUDE SEVERAL DETAILED STUDIES OF THE TAKE-OR-PAY ISSUE IN RESPONSE TO THE SPECTRE OF IMPENDING DISASTER RAISED BY INTERSTATE PIPELINES OSTENSIBLY DUE TO TAKE-OR-PAY CONTRACT CLAUSES.

A CLOSE EXAMINATION OF THIS ISSUE IN A STUDY CONDUCTED FOR N-G-S-A BY FOSTER ASSOCIATES IN 1984, REVEALED THAT THERE WAS NO WIDESPREAD TAKE-OR-PAY PROBLEM PLAGUING THE ENTIRE INTERSTATE PIPELINE SYSTEM, AND CERTAINLY NO PROBLEM THAT COULD NOT BE SETTLED BY PRIVATE PARTY NEGOTIATIONS.* THIS STUDY DEMONSTRATED THAT THE "PROBLEM" TAKE-OR-PAY LIABILITIES WERE CENTERED ON ONLY FOUR OUT OF THIRTY-SIX MAJOR INTERSTATE PIPELINES.

TODAY, MANY PIPELINES ARGUE THAT "POTENTIAL" TAKE-OR-PAY LIABILITIES SOMEHOW CREATE A JUSTIFICATION FOR NOT BECOMING

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* SEE ANALYSIS OF THE TAKE-OR-PAY PROBLEM, FOSTER ASSOCIATES, INC., PREPARED FOR THE NATURAL GAS SUPPLY ASSOCIATION, MARCH 1984, AT 3 - 4.

NON-DISCRIMINATORY TRANSPORTERS. A CAMPAIGN IS BEING CONDUCTED TO CONVINCE POLICY-MAKERS THAT TAKE-OR-PAY LIABILITIES, AND THE ALLEGED LACK OF RELIEF FROM PRODUCERS ON SUCH CONTRACT CLAUSES, CAUSED SUCH A PROBLEM THAT LEGISLATIVE OR REGULATORY RELIEF IS NEEDED.

DOCUMENTED EVIDENCE SUCH AS THAT IN APPENDIX B AND THE ATTACHMENTS THERETO, SHOWS THAT THESE CLAIMS ARE GENERALLY FALSE. FACTUAL, OBJECTIVE DATA DEMONSTRATES THAT PRODUCERS HAVE GRANTED INTERSTATE PIPELINES SUBSTANTIAL TAKE-OR-PAY RELIEF AND, IN THEIR OWN INTEREST, WILL DO SO IN THE FUTURE TO SUSTAIN SALES.

DOCUMENTS FILED BY THE PIPELINES WITH THE F-E-R-C AND COMMENTS MADE BY REPRESENTATIVES OF THE PIPELINES BEFORE CONGRESSIONAL COMMITTEES AND IN THE PRESS DEMONSTRATE THAT MULTIPLE AND OFTEN CONTRADICTORY MESSAGES ARE BEING DELIVERED ON THE ISSUE OF CONTRACTUAL DISPUTES AND PARTICULARLY TAKE-OR-PAY SETTLEMENTS: TO THE FINANCIAL INDUSTRY THESE ISSUES ARE REPRESENTED AS WORKABLE; TO POLICY-MAKERS IT IS ARGUED BY THE PIPELINES THAT DISASTER IS IMMINENT.

IT SHOULD BE NOTED THAT PIPELINES HAVE NOT SUFFERED FINANCIALLY FROM THE TAKE-OR-PAY "ISSUE" AS EVIDENCED BY THE FACT THAT THE AVERAGE RETURN ON COMMON EQUITY FOR TWENTY-FIVE MAJOR INTERSTATE PIPELINES GREW FROM 14.12 PERCENT IN 1981 TO 16.89 PERCENT IN 1984 (RECALL THAT INTERSTATE PIPELINES ARE REGULATED MONOPOLIES). FURTHERMORE, PIPELINE COMPANY ANNUAL REPORTS NOTE THAT THIS SEGMENT OF THE INDUSTRY GENERALLY EXPECTS FULL RECOVERY OF ANY TAKE-OR-PAY PAYMENTS BY PASSING ON SUCH COSTS TO CONSUMERS. MOREOVER, THE ACTUAL COST OF TAKE-OR-PAY SETTLEMENTS ARE A SMALL FRACTION OF THE TOTAL LIABILITIES BEING PUBLICLY CLAIMED. (SEE APPENDIX B.)

DURING HEARINGS BEFORE THE HOUSE FOSSIL & SYNTHETIC FUELS SUBCOMMITTEE ON NOVEMBER 13 AND 14 OF LAST YEAR, PRODUCER WITNESSES FROM N-G-S-A MEMBER COMPANIES EXXON AND CONOCO TESTIFIED THAT IN MANY CONTRACTS, TAKE-OR-PAY FUNDS FOR GAS ARE PUT INTO A SPECIAL ACCOUNT; PRODUCERS CANNOT "BOOK" THOSE MONIES UNTIL SUCH TIME AS THE GAS IS ACTUALLY TAKEN. THESE WITNESSES ALSO TESTIFIED THAT IF THE GAS IS NEVER TAKEN, THE FUNDS, AFTER A PERIOD OF TIME (GENERALLY FIVE YEARS), ARE RETURNED TO THE PIPELINE. THE PIPELINES' LOSS OF THE TIME VALUE OF SUCH FUNDS IS ESSENTIALLY A PAYMENT

TO PRODUCERS FOR THE STORAGE OF THE GAS ON BEHALF OF THE PIPELINE.

SUMMARIZING THE CONSIDERABLE DATA ATTACHED TO APPENDIX B, IT IS FAIR TO SAY THAT THERE HAS BEEN A HIGH LEVEL OF TAKE-OR-PAY RENEGOTIATION. N-G-S-A CONDUCTED A SURVEY OF SEVERAL MEMBER COMPANIES (AMOCO, ARCO, ASHLAND, CHEVRON, CONOCO, EXXON, MARATHON, MOBIL, PHILLIPS, SHELL, SUN, TEXACO, CHAMPLIN, CITIES SERVICE, UNOCAL), TO DETERMINE THE AMOUNT OF TAKE-OR-PAY LIABILITIES SETTLED DURING THE PERIOD 1981 - 1985. THE RESULTS OF THIS SURVEY SHOW THAT SETTLEMENTS HAVE OUTPACED NEW LIABILITIES BY A 2 TO 1 RATIO AND THAT MOST OF THE REMAINING POTENTIAL LIABILITY IS OF RECENT ORIGIN. DURING THIS PERIOD, N-G-S-A'S MEMBERS HAVE SETTLED $5.7 BILLION OF ACCUMULATED PIPELINE TAKE-OR-PAY LIABILITIES OF $8.5 BILLION. THE REMAINING AMOUNT IS OF RECENT (1985) ORIGIN.

AS I STATED EARLIER, NOW IS THE TIME TO GET THE GOVERNMENT OUT OF NATURAL GAS WELLHEAD REGULATION. THE NATURAL GAS INDUSTRY AND ALL NATURAL GAS CONSUMERS WILL BENEFIT IMMENSELY BY SUCH ACTION. COMPREHENSIVE NATURAL GAS

LEGISLATION SUCH AS S.1302 WHICH YOU AUTHORED, MR. CHAIRMAN, AND LIKE THE D-O-E LEGISLATION INTRODUCED LAST WEEK IS CERTAINLY THE APPROPRIATE APPROACH TO THESE PROBLEMS.

THANK YOU FOR THIS OPPORTUNITY TO APPEAR AND PRESENT THE VIEWS OF THE NATURAL GAS SUPPLY ASSOCIATION. I WOULD BE PLEASED TO ANSWER ANY QUESTIONS WHICH YOU MAY HAVE.

Senator NICKLES. Mr. Nelson, thank you very much. Our next panelist is Irene Wischer, Panhandle Producing Co., from San Antonio, TX, chairman of the Natural Gas Committee, representing the Independent Petroleum Association of America.

STATEMENT OF IRENE WISCHER, CHAIRMAN, NATURAL GAS COMMITTEE, INDEPENDENT PETROLEUM ASSOCIATION OF AMERICA

Ms. WISCHER. Thank you, sir. I am also president of the Oil & Gas Exploration Co., the nonjurisdictional pipeline company, and a well servicing company, and I am here to validate 32 years of confusion as concerns the regulation of gas prices at the wellhead.

As late as 1980, I was among those still trying to explain shortages and was entering into gas sales contracts with pipelines, providing incentives for me to find and produce more gas. Today, I am trying to understand why those same pipelines are abrogating the contracts with me in the late 1970's and early 1980's, both as to price and deliberability, and why, as a producer, I don't have the same privilege.

I am not here to tell the Government how it can run my business. I am here to ask Government to provide legislation which would at long last totally deregulate natural gas; to do something which Government has failed to accomplish for more than 30 years, when all we see today are multiple pricing distortions and discrimination in the marketplace—which, by the way, is costing the Federal Government and the petroleum industry billions of dollars.

But I am also here to commend your committee for allowing us to make these appearances. I am also here to represent the producers who enthusiastically support Secretary Herrington's natural gas decontrol proposal. We need repeal of the end-use constraints. We want to see an end to incremental pricing, which has been mentioned several times here today, and we must have contract carriage and open transportation. We can no longer be held hostage by the pipelines.

The administration's bill will accomplish this. We ask also that legislation include language to assure that market prices are accepted by Federal agencies for royalty purposes.

With supplies plentiful today and the spot market prices dropping daily, along with oil, it should make little or no difference to the consumer to now move forward with comprehensive gas legislation. One of the best and most timely ways to avoid more import dependence is to use more natural gas.

There is time to act on the administration's proposal and we would urge you to do so.

Thank you, very much.

[The prepared statement of Ms. Wischer follows:]

INDEPENDENT PETROLEUM ASSOCIATION OF AMERICA

Statement of the

Independent Petroleum Association of America

before the

Subcommittee on Energy Regulation and Conservation

of the

Senate Committee on Energy and Natural Resources

On the Issue of Pending Natural Gas Legislation

April 15, 1986

I am Irene Wischer, an independent oil and gas producer from San Antonio. I am appearing here today as Chairman of the Natural Gas Committee of the Independent Petroleum Association of America. I am speaking on behalf of the nearly 6,000 association members who produce crude oil and natural gas, operating in all of the domestic oil and gas provinces of the U.S., particularly onshore in the lower 48 states.

We are pleased to have the opportunity to appear before you today to address the wide variety of legislative proposals which have been introduced dealing with the use, sale, and transportation of natural gas.

First, Mr. Chairman, let me commend you for your interest in this subject and for your willingness to propose legislative solutions to the problems the natural gas industry faces in these difficult times. We are particularly pleased by your recent increased interest in a transportation initiative.

Each of the proposals before you have a great deal of merit and we will not attempt today to choose one over the other. Clearly, by adding a transportation proposal to your decontrol and end use restriction repeal bill, the Committee would produce a sound comprehensive measure. The Administration's proposal, while slightly different than yours, surely would be a step forward and should receive the strong consideration of this Committee.

Senator Gramm's proposal also has much merit although independents would like to see a stronger transportation section adopted. Still other proposals, such as the one introduced by Senators Johnston and Domenici, are positive efforts, even though they address only a portion of the problem.

As we see it, the natural gas problem focuses on three primary areas -- (1) transportation, (2) remaining natural gas act dedication and price controls, and (3) end use restrictions. We believe it is necessary and urgent for Congress to address all three areas and beleive it is possible to do so within a reasonable time frame if Congress has the will.

In addition, independents believe two other issues should be addressed. First, we urge that you act to exempt small producer cooperatives from anti-trust actions. In 1983, the Committee, included the so-called Wallop Amendment, which did this, as a part of S 1715. We would urge the Committee to adopt such a provision again as a part of any legislation it reports.

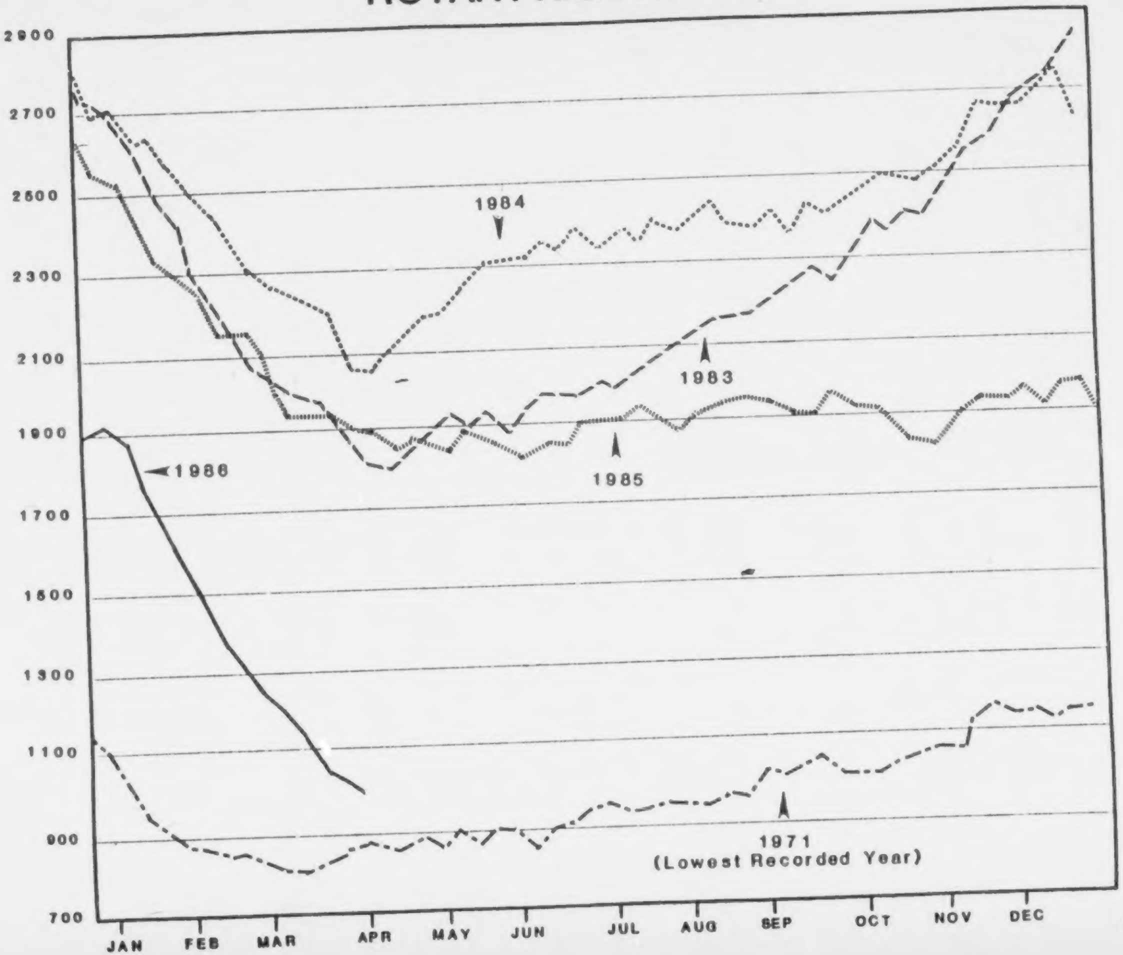
Secondly, none of the proposals contain a "royalty" provision as included in S 1715. Producers are still fighting with agencies controlling public lands over proper royalty levels. You should include language which would make it clear that prices actually paid for the gas be acceptable to the Federal government as the basis for royalty payments on Federal lands.

As a preface to our further discussion of the natural gas legislative proposals, we would like to discuss with you some of the developments since we last appeared before you on November 21, 1985.

At that time, we alerted you to problems associated with the 1985 decline in drilling rig activity. We were concerned that the year end rig count would be only about 1,900 active rigs, 800-900 below the previous two years and well below 1981 and 1982. While 1,900 active rigs was basis for alarm at that time, a look at the chart on the following page should cause serious concern. Not only did we end up the year at about 1,900, but since then, activity has fallen to less than 1,000 and we rapidly are approaching the record low drilling levels of 1971. One doesn't need to be in the oil and gas business to be concerned about those numbers if you are concerned at all about domestic energy security in the longer term.

When we last were here, we and other witnesses were hopeful that the FERC's new Order 436 would help us move more gas. This is vital to independent producers faced with severe cash flow problems. Because, even with gas prices falling sharply -- spot prices are below $2 per Mcf -- many small producers have had their wells shut in or sharply curtailed at any price due to the lack of transportation services. While price levels are an important element of net cash income, volumes sold are just as important and many independents have been shut out of the marketplace.

ROTARY RIGS ACTIVE



IPAA Chart

Because of the DC Court of Appeals' decision, Special Marketing Programs, which had offered us some volumetric relief, came to an end on November 1, 1985 and Order 436 was supposed to take over. However, since that time only a handful

of pipelines have come forth to be full open access carriers and huge volumes of gas remain shut in while willing buyers have had to turn to more costly alternatives. With sharply dropping crude oil and product prices, unless something is done quickly to open up transportation services to direct sales, the gas market will shrink even further.

In addition, since we last appeared before the Committee, the FERC has initiated a rulemaking based on a DOE request to raise old gas price ceilings to attempt to further encourage the voluntary renegotiation of all troublesome gas contracts. That proceeding is moving towards an expected conclusion around June 1 and its future is uncertain as issues covering old gas pricing as well as transportation are being clouded by continued demands from pipelines and distributors for the FERC and/or Congress to act to abrogate producer contracts in the name of take-or-pay relief.

If this Committee does act to move any of the pending bills, we are sure you will be confronted with similiar demands for take-or-pay relief and relief from non-market responsive contracts. We would like to make a few points on this issue.

Advocates of action to abrogate these contracts act as if they had nothing to do with writing or signing them -- that the government or some other party dictated the terms and pipelines and distributors were forced to sign them. This is not so.

These contracts were truly arm's length, two-party contracts when they were signed. No one held a "gun" at anyone's head.

Gas is no different than anything else. The difference between a good contract and a bad contract can be judged only against time. Hind sight always is 20-20.

If these were not sound contracts at the time they were entered into, then pipelines should be confronted by their stockholders and customers. But instead, it is being suggested again and again that action should be taken at the Federal level to force producers to take less than called for by the contract. Why should only one party to a contract which subsequently "turns sour" be expected to assume all of the costs associated with what we know now were not the best management decisions?

Let me give you a parallel example. At the time these "troublesome" contracts were signed, many producers were expanding their operations. It was not uncommon for a producer to borrow money at 18 percent to purchase a $3 million drilling rig. A lot of money? Yes. High interest rates? Yes. But the way things were going at the time, that deal could work with gas approaching $4 per Mcf and high take levels.

But today, with spot gas prices below $2 and interest rates 5-6 points lower, the rig deal was a bad deal. But is the bank eating it? Is the rig manufacturer expected to lower his price after the fact? Of course not, and producers are either sticking with the deal and paying for it out of other income or through disposition of other assets -- or through Chapter 11.

The same is true of the farmer who bought land at inflated prices a few years ago or the copper miner who opened a mine ten years ago when demand for copper was high. The developer in Oklahoma City who "built for the future" and the retailer in Peoria who expected Caterpiller and International Harvester to continue to grow are faced with handling "bad deals" today that looked like "good deals" a few short years ago. But they aren't calling upon the Federal Government to abrogate contracts they entered into in better times.

Lest we be misunderstood, gas producers are not insensitive to market conditions. Many have agreed to cut contract prices and grant pipelines take-or-pay relief only to see those pipelines and their distributor customers maintain such high margins that consumers still abandoned gas service. Producers don't belive they should be expected to swap "take-or-pay" for "give and take" -- producers give and middlemen take. If pipelines and distributors are in such dire straights, why haven't we seen any bankrupcies in those sectors -- why should producers be the only ones faced with total loss?

If Congresss can spend a year and a half on counter-productive tax legislation in the name of "fairness" surely it could direct a little of it's desire for "fairness" to this issue.

While we are sure that the Committee will be told that none of the legislative proposals before you deal with the take or pay issues, we would point out that at least three of the proposals do.

Mr. Chairman, your proposal would lead to a resolution of the take or pay problem. The Administration proposal addresses it. Senator Gramm's proposal does likewise.

How, you ask? Through the removal of price and non-price constraints on old gas. That would put _all_ contracts on the table at the same time so renegotiation could be a truly two-party affair. In this manner, a "bad" producer contract could be balanced against a "bad" pipeline contract with both parties having a role in the give and take process.

It is being argued by some that the Congressional schedule is too crowded to deal with natural gas this year. We believe that is more an excuse for inaction than a reason for delay.

The domestic petroleum industry is in trouble. Our trouble is a national problem which will bring a return to dangerously high levels of imported crude oil.

One way, with little cost to anyone, to slow the growth of imports is to take action now to clear the way for the use of more natural gas -- a secure domestic energy source which is in a surplus deliverability position. It would be a national shame to see oil imports rise in part because institutionalized impedements to the transportation, sale, and use of natural gas were allowed to stand because Congress was too busy to address the issues. For once, we challenge Congress to act before the full crisis is upon us again.

Thank you.

Senator NICKLES. Thank you, very much, for your comments.

Our next panelist is Bud Lawrence, president of American Gas Association. Mr. Lawrence.

STATEMENT OF GEORGE H. LAWRENCE, PRESIDENT, AMERICAN GAS ASSOCIATION

Mr. LAWRENCE. Mr. Chairman, Senator Ford, I believe we are here today to take a major step to getting Federal Government intrusions out of the natural gas industry on both the supply and demand side.

AGA has adopted a new legislative position on natural gas pricing which will lead to market responsive wellhead prices. We are willing to change our longstanding position and support oil-gas decontrol as contracts expire or are renegotiated, as proposed in S. 1302, so long as Congress is willing to let free market forces bring down the price of NGPA regulated new gas.

Specifically, on the latter point, we are calling for, one, removal of all remaining NGP price ceilings on new gas, and second, elimination of indefinitie escalator clauses in contracts for the sale of that gas which have no place in today's competitive market.

Together, these steps will allow wellhead prices to respond to market forces so that the weighted average cost of gas per interstate pipelines would decline by, in our estimation, some 28 to 34 cents.

We don't believe the wellhead price will decline by that amount, but that the average of pipeline system gas would so decline and permit it to compete with spot gas. This would mean lower consumer prices, reductions in the $6 billion potential take-or-pay obligation, increased demand and increased producer revenues through more sales.

We oppose the DOE's proposal to have FERC decontrol old gas. Only Congress has that power and we are asking Congress to use that power and bring both old and new to the market-responsive level.

We do note, Senator Nickles, that S. 1302 would add a new section, F.5, which could be construed as immediately deregulating life-of-lease gas. We believe this language is ambiguous, contrary to the spirit of the bill and we recommend that it be deleted.

The disposition on gas pricing should, in no way, detract from ongoing efforts to repeal statutory restraints on the use of gas. Incremental pricing, where large industrial customers are forced to pay a gas-use surcharge is even more unworkable in today's highly competitive market. It results in distortions in gas-to-gas competition, as well as loss of oil.

Bureaucratic inertia of collecting and posting these surcharges in the Federal Register results in foreign oil replacing domestic natural gas.

Repeal of the Fuel Use Act and incremental pricing, as proposed in bills by Senators Domenici and Johnston, and yourself, would improve demand for U.S. gas, provide needed revenue incentives for producers, alleviate take-or-pay for pipelines, provide more efficient energy applications for many industrial users and for electric generation, reduce fixed cost allocations to all consumers, permit a more flexible and market-oriented approach to environmental goals and reduce temptations to rely on imported energy, whether it is Canadian hydropower, or crude oil—from wherever in the world.

Now, that is a pretty good list of plusses, but as is often the case, good energy policy is blocked for reasons that make no sense.

We have heard three reasons to postpone action on fuel use and incremental pricing repeal. One that we heard here this morning from Secretary Herrington is that the DOE will grant exemptions as needed. The exemption process is an impediment. It can take up to a year and cost as much as $100,000 for the filing. These applications have tripled over the past year and are going to go up more.

AGA has prepared a how-to manual and it is very complicated to comply with this exempt process.

But I think more important are those projects that die in the planning stages because the user has neither the patience for nor the confidence in a Federal exemption process for something vital to his way of doing business.

The second point we hear is this fear of a gas shortage in the future. Some conjure up alleged supply problems in the 1990's, but the clear and present danger is lack of demand today. Past strategies were the result of Federal fuel price controls. There is no shortage in the resource base.

Controls are now off of the gas exploration and this industry can and will respond with a growing supply to meet a growing demand.

Finally, we hear repeal must be hostage to decontrolling old gas. This is a classic case of cutting off your nose to spite your face. We are ready to support gas pricing legislation on its merits.

These reasons for inactions have been effective but they are wrong. There is one step Congress can take to benefit everybody, and that is to repeal these market restraints. Thank you.

[The prepared statement of Mr. Lawrence follows:]

TESTIMONY OF GEORGE H. LAWRENCE
FOR THE
AMERICAN GAS ASSOCIATION
BEFORE THE
SUBCOMMITTEE ON ENERGY REGULATION AND CONSERVATION
OF THE
SENATE COMMITTEE ON ENERGY AND NATURAL RESOURCES
HEARINGS ON GAS PRICING AND REPEAL OF THE POWERPLANT
AND INDUSTRIAL FUEL USE ACT AND INCREMENTAL PRICING
April 15, 1986

I am George H. Lawrence, President of the American Gas Association (A.G.A.). On behalf of the 300 natural gas distribution and transmission companies that are members of A.G.A., I am pleased to appear before the Subcommittee this morning.

STATEMENT OF POSITION

Repealing the Powerplant and Industrial Fuel Use Act (FUA) and incremental pricing under Title II of the Natural Gas Policy Act (NGPA) have long been among the highest legislative priorities of A.G.A. This is even more true today in this era of falling oil prices.

A.G.A. has also adopted a new legislative position on natural gas pricing which will lead to market-responsive wellhead prices. A.G.A. is willing to change its long-standing support for controls on old gas and support old gas decontrol for expired and renegotiated gas contracts as proposed in S. 1302, sponsored by Subcommittee Chairman Don Nickles (R-OK), if Congress is willing to let free market forces bring down the price of NGPA regulated new gas. Specifically, we are calling for:

(1) the immediate removal of all remaining NGPA price ceilings on new gas, [1] which are keeping prices for this gas at roughly twice market levels; and,

(2) the elimination of indefinite escalator clauses, [2] in contracts for the sale of that gas, which were signed when the parties thought that this gas would never be decontrolled under the NGPA. The proposal to eliminate indefinite escalator clauses would not apply to: (a) already deregulated gas; (b) old interstate gas; or (c) future contracts.

Together, these steps would allow wellhead prices to respond to market forces, so that the price paid by interstate pipelines in the field would decline by as much as 34 cents/MMBtu, and be reflected in their weighted average cost

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1/ This encompasses NGPA §§102(d), 103(b)(2), 105(b)(3), 107(c), 108, and 109.

2/ Our definition of an indefinite escalator clause is along the lines of NGPA §105(b)(3)(B)(i). It is:

> DEFINITION OF INDEFINITE PRICE ESCALATOR CLAUSE -- For purposes of this paragraph, the term "indefinite price escalator clause" includes any provision of any contract --
>
> (i) which provides for the establishment or adjustment of the price for natural gas delivered under such contract by reference to prices for natural gas, including any price determined by reference, direct or indirect, to an NGPA ceiling price, for crude oil, or for refined petroleum products; . . . .

Note that our definition excludes any reference to subsection (ii) of §105(b)(3)(B), and does not affect price renegotiation clauses.

of gas (WACOG). Decreased WACOGs would mean lower consumer prices, reductions in our industry's $6.2 billion potential take-or-pay obligation, and soon thereafter, increased demand and producer revenues.

A.G.A. did not arrive at this new position lightly. Lengthy deliberations and analytical studies preceded our decision. We are, even now, vigorously opposing the Department of Energy's (DOE's) proposal to decontrol old gas by administrative fiat of the Federal Energy Regulatory Commission (FERC). Only Congress has the power to decontrol old gas and can use that power judiciously to ensure that, as old gas prices are allowed to rise, new gas prices are also allowed to fall. NGPA new gas ceilings have in effect become price floors and are holding controlled new gas prices at unreasonably high levels.

The benefits of our proposal arise from subjecting NGPA regulated new gas to market forces by removing price ceilings and escalator clauses -- not from decontrolling old gas. As we have said many times before, the principal problem in today's market is not the low price of old gas but the high price of nonmarket-responsive gas. Thus, the many consumer benefits of lower prices and reduced take-or-pay expenses come from making this NGPA regulated new gas totally market responsive. Despite our concerted efforts to make this point with DOE and FERC, they have consistently ignored the problems with high cost, nonmarket-responsive gas contracts. The Commission's inability or unwillingness, to date, to deal with high priced, nonmarket-responsive gas contracts has convinced us that Congressional action is needed on gas pricing.

The ultimate goal should be to make all gas, old and new, market-responsive. In today's volatile energy marketplace, which is dominated by rapidly declining crude oil and product prices, we need to do everything possible to stimulate gas demand by making prices more market-responsive and removing outdated constraints on its use. Our proposal will provide immediate and tangible benefits to natural gas consumers, end users, distribution companies, pipelines, and producers -- as well as to the nation's economy, its security and its environmental goals.

However, this position on gas pricing should in no way detract from parallel efforts to repeal FUA and incremental pricing as soon as possible. Indeed, the new focus on wellhead pricing further confirms the need to put the repeal of demand restraints on a separate legislative track, so that action to repeal FUA and incremental pricing proceeds forthwith.

We now turn our attention to some of the specific legislative proposals before this Subcommittee. First, we will discuss Chairman Nickles' bill, entitled the "Natural Gas Regulatory Reform Act of 1985." Second, we will discuss the DOE bill, S. 2285, and its many flaws. Third, we will discuss the "Natural Gas Utilization Act of 1985" (S. 1251). This bill was introduced by Senators Pete Domenici (R-NM) and Bennett Johnston (D-LA) on June 6, 1985, to repeal FUA and incremental pricing. Chairman Nickles has also introduced a FUA repeal bill, S. 2205. It is time, and past time, to move forward on stand alone repeal of these clearly counter-productive market restraints.

I.

The Nickles Bill -- S.1302

S. 1302 takes a free market approach to old gas decontrol -- permitting decontrol either upon contract expiration or renegotiation. Thus, all old gas is eligible for decontrol if the buyer and seller can work out the terms, with about 6 percent of old gas automatically decontrolled as contracts expire each year. However, we would note that S. 1302 would add a new §(f)(5) to NGPA §121. This new subparagraph could be construed as decontrolling old gas before life of lease contracts expire and is contrary to the spirit of the bill, which achieves old gas decontrol consistent with contract terms or renegotiation by the parties. Section (f)(5) creates an anomolous situation wherein life of lease gas is deregulated immediately while long-term contract gas stays regulated until contract expiration or renegotiation. Clearly, the parties would expect life of lease contracts to give them more protection than even long term contracts. To eliminate any possible ambiguity, we strongly recommend that §(f)(5) be deleted.

The market can more than offset annual price increases from 6 percent of old gas by lowering new gas prices *if* the remaining categories of NGPA regulated new gas are also decontrolled and indefinite escalator clauses are disabled. According to A.G.A.'s analysis (attached), our proposal will lower the national WACOG by 28 to 34 cents/MMBtu, depending on the underlying assumptions. Under one set of assumptions, all decontrolled gas goes to market levels, resulting in a savings of 34 cents/MMBtu. Some currently decontrolled gas is kept above market levels because of contract terms. Therefore, under a second set of assumptions, newly decontrolled gas (*e.g.* §102d) goes to the same level as currently decontrolled gas in the same category (§102c), resulting in a savings of 28 cents/MMBtu. The second assumption is conservative, given the escalator clause protection built into our proposal; however, it reflects the presence of specific numerical above-market floors in some new gas contracts.

When all of the various categories of gas are examined, we see that as old gas rises to an assumed market price of 57% of crude oil, new gas prices also fall to 57% of crude oil.[3] Because of the mix of old and new gas, declining prices more than offset rising prices, creating a net benefit for the consumer, lowering gas prices, increasing demand and reducing now proliferating take-or-pay obligations. We expect that if old gas is gradually decontrolled as contracts expire or immediately decontrolled as contracts are renegotiated, as prescribed in S. 1302, its price would rise to market levels. For example, the average price of §104/106(a) gas is now $1.39/MMBtu. Under S. 1302, the average old gas price would rise via contract expiration to $1.46/MMBtu in the first year. However, this price increase can be offset by lower new gas prices if A.G.A.'s proposal is adopted, mitigating potential consumer price increases from old gas decontrol.

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[3] Our analysis assumed $18/barrel crude oil and $16/barrel high sulfur residual oil.

The price effect of old gas which is decontrolled by renegotiation cannot be quantified. However, it is assumed that the purchaser could get a quid pro quo in the form of price reductions or take-or-pay relief on nonmarket-responsive contracts. The renegotiation option is mutually beneficial to producers and pipelines because it gives both parties greater flexibility in contract adjustments to achieve marketability to their mutual benefit.

By preempting favored nation and related indefinite escalator clauses, Congress would prevent irrational, unintended and anticompetitive effects on gas prices. Many NGPA regulated new gas contracts include indefinite escalator clauses which the parties expected to be restrained, in perpetuity, by NGPA ceiling prices, imposed in §§104, 105(b)(3), 106(a), 102(d), 107(c)(5), 103(b)(a), 108, and 109. These clauses were never intended to ratchet gas prices far above market levels. Instead, they were intended to permit prices to rise to these ceilings, which were expected to be below market levels.

If ceiling prices are removed, then the contract no longer embodies the parties' expectations about escalator clauses. Escalator clauses in just a few such contracts could take the price of most newly deregulated gas, once again, above market levels. Moreover, such contracts may activate escalator clauses in other contracts, creating a chain reaction of ever-increasing prices. Pipelines would once again have to refuse to take this above market gas, starting the cycle of shut-in gas, take-or-pay obligations and higher consumer prices.

The solution is to deactivate such escalator clauses before the cycle starts, just as Congress did when it enacted the NGPA. By passing the NGPA, Congress changed the rules of the game. Thus, NGPA §313 declares that §§107, 302(a) and 303 prices cannot trigger escalator clauses. If Congress changes the rules of the game again by removing NGPA price ceilings, it can certainly take action on escalator clauses again. Most contracts for currently deregulated gas were negotiated in anticipation of the complete deregulation of new gas on 1/1/85, and the parties could protect themselves accordingly. However, parties contracting for controlled NGPA new gas felt entitled to rely on the NGPA ceilings. If the ceilings are removed by law, it is entirely consistent to remove by law those anti-current market contractual provisions negotiated in reliance on the ceilings.

Since eliminating escalator clauses might leave the parties without a price determination clause, the parties should have 60 days to renegotiate. If at the end of that time, the parties cannot agree, then the producer is free to sell the gas elsewhere and the released pipeline would be required to transport the contracted for volumes of gas to its nearest major point of interconnection. This transportation "access" will allow the producer to get gas out of the field and offer it to another buyer and/or transporter.

We think that this is a fair solution to an old and difficult problem. Unlike earlier suggestions to "cap" escalator clauses according to a preset formula, our suggestion relies entirely on market forces. Thus, we believe that it is more in keeping with the free market spirit of decontrol. While many now-controlled old gas contracts, under §§104 and 106(a), also contain these outmoded indefinite escalator clauses, they pose no problem under the basic approach of S. 1302 because they too would expire as old gas is decontrolled via contract expiration, or they would be eliminated during renegotiation.

II.

The DOE Bill -- S. 2285

Unlike a modified Nickles bill, DOE's bill will not create a competitive wellhead market for three reasons:

First, the DOE bill precipitously decontrols old gas on 4/1/87.

Second, the DOE's bill ignores the effects of anti-current market indefinite escalator clauses on gas prices, after NGPA ceilings are removed; and

Third, the DOE bill imposes a new layer of statutory Federal controls on natural gas transportation just as the industry is on the verge of entering into self-implementing transportation.

We will discuss each of these points below.

II.A.

Precipitously Raising Old Gas Prices Will Not Lower New Gas Prices

It is erroneous to assume -- as DOE does -- that an immediate increase in old gas prices would be more than offset by a commensurate decrease in new gas prices. Despite intense gas-to-gas competition, increasing gas-to-oil competition, and growing take-or-pay obligations as pipeline sales are displaced by carriage, the price of about 20 percent of interstate pipeline supplies remains at roughly twice market rates because of nonmarket-responsive new gas contracts. Since the price of new gas cannot automatically fall on decontrol day, 4/1/87, unless the indefinite escalator clauses are disabled, the consequences of precipitously decontrolling old gas are:

- First, precipitously raising old gas prices, will force pipelines to cut back purchases of high cost nonmarket-responsive new gas to keep pipeline sales rates competitive; and,

- Take-or-pay liabilities will increase at a faster rate because pipelines will have to refuse to take even more high cost new gas to keep their sales rates competitive with spot gas and falling oil prices.

A.G.A. estimates that potential take-or-pay obligations could exceed $7 billion in 1986, and even with recent settlements and contract renegotiations potential obligations remain at $6.2 billion. The latest A.G.A. study (attached), an Energy Information Agency (EIA) study, and information from the Interstate Natural Gas Association of America all corroborate this figure. Furthermore, our estimate is also consistent with an analysis by the Natural Gas Supply Association (NGSA) on the take-or-pay obligations of selected pipelines -- when NGSA's data is updated with information from more recent annual reports. These estimates, though large, do not take into account the effect of raising old gas prices, which would force pipelines to refuse to take even more high price gas.

While the supply benefits of old gas are subject to debate, DOE's suggestion that old gas decontrol will elicit 30-34 Tcf of old gas is absurd. While there undoubtedly will be some long term supply response from old gas decontrol, it can be agreed by all reasonable parties that there will be no measurable supply response in the short-term, given the current gas price outlook. Therefore, the economic benefits shown by DOE this decade do not exist.

II.B.

Problems With Old Gas Contracts

Because the DOE bill abruptly eliminates ceiling prices, indefinite escalator clauses in both old and new gas contracts could distort gas prices. In contrast, the Nickles' bill as modified by our proposal avoids this problem. First, since S.1302 does not repeal ceiling prices during the life of the contract, existing escalator clauses for old gas are never a problem. Second, our proposal preempts indefinite escalator clauses in contracts for NGPA regulated new gas that would be decontrolled.

A recent study by the Energy Information Agency, entitled An Analysis of Natural Gas Contracts, Volume I: Old Interstate Gas (February, 1986), predicts that repealing old gas ceilings may create new pricing distortions. If old gas ceiling prices are removed, contract clauses in 80 percent of all old gas contracts would take the price of that gas above market rates in some cases, and below present prices in other cases. For example: (a) as much as 30 percent of old interstate gas could revert to very low, pre-NGPA prices; (b) 7 percent of old gas is indexed to oil and could go above market levels; (c) 34 percent of old gas contracts include most favored nation clauses that could take old gas prices above market levels; and (d) 10 percent of all old interstate contracts have only fixed price escalator clauses. Thus, removing the old gas ceiling price does not mean that old gas prices will be market-driven.

DOE's proposal to abolish ceiling prices, without dealing with the escalator clause problem, shows a profound disregard for the consequences of run away escalator clauses, despite the warnings of an Agency that is actually within the Department of Energy.

II.C

DOE Proposes A New Layer of Federal Controls On Natural Gas Transportation

In the midst of a proposal that ostensibly deregulates natural gas, DOE has inserted a mandatory carriage provision that gives FERC the power to order interstate pipelines to carry gas. This provision would put FERC in the business of assigning pipeline capacity customer-by-customer and of substituting the Commission's judgment for pipeline operating decisions. Aside from the fact that this proposal is a bureaucratic nightmare and totally unnecessary, it is a genuine curiosity that a proposal to, in effect, nationalize private pipeline property, arises from a Department of this free market-oriented Administration. Furthermore, since the Secretary of Energy refers to his proposal as a "transportation bill", then consideration should be given to transferring -- at least this portion of the bill -- to the Senate Commerce Committee.

The Commission has just started to put a completely self-implementing transportation program in place. Despite DOE's assertions to the contrary, to date, 17 pipelines have filed petitions to transport gas under Order 436 (see Table

I, attached). Furthermore, we expect more pipelines to file for transportation under the program by July 1, 1986, a mere two and a half months from now. Certainly, self-implementing transportation under Order 436 would be even more quickly accepted if A.G.A.'s market-responsive legislative proposal is adopted.

In the interim, transportation is continuing to take a larger and larger share of the market. According to A.G.A. statistics, gas pipeline and utility transportation to end users totalled nearly 1.4 Tcf in 1985, a 63% increase over 1984. This represents 10% of total gas utility deliveries in 1985, and 20% of gas utility industrial and electric generation deliveries.

Pipelines' reluctance to accept Order 436 should not be interpreted to mean that they are hostile to transportation. Instead, their reluctance to join the Order 436 transportation program is a reflection of their reluctance to shoulder more take-or-pay liability. We have told the Commission repeatedly, in all our filings on Order 436 and more recently on administrative decontrol, that the possibility of aggravating take-or-pay obligations is the single greatest impediment to "open access" transportation, and FERC has repeatedly acknowledged that this is true.4/ However, on March 26, 1986 the Commission again refused to

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4/ See:

Statement of Policy Cocerning Take-or-Pay Provisions In Gas Purchase Contracts, 47 Fed. Reg. 57268, (December 23, 1982).

FOOTNOTE CONTINUED

even address the issue of nonmarket-responsive new gas contracts with onerous take-or-pay obligations. A.G.A. intends to appeal the lack of meaningful relief on non-market responsive contracts in Order 436 to the U.S. Court of Appeals.

In the interim, we urge Congress to remove the remaining new gas ceiling prices and to preempt indefinite escalator clauses in these contracts. As soon as new gas becomes market-responsive, the take-or-pay problem will begin to disappear. With lower prices, pipelines will be able to take and sell more gas. They will be able to retain and even regain load lost to oil. If FUA and incremental pricing are also repealed, demand will increase further. The best solution to the take-or-pay problem has always been to sell more gas.

III.

Domenici/Johnston -- S. 1251

Repeal of the Powerplant and Industrial Fuel Use Act (FUA) and the incremental pricing provisions of the NGPA is a high A.G.A. legislative priority. The FUA prohibits new

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Elimination of Variable Costs from Certain Natural Gas Pipeline Minimum Commodity Bill Provisions: Final Rule, 49 Fed. Reg. 22778, 22787 (June 1, 1984).

Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol; Notice of Proposed Rulemaking, 50 Fed. Reg. 24130, 24133 (June 7, 1985).

Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol; Final Rule, 50 Fed. Reg. 42408, 42433 (October 9, 1985).

electric power installations and industrial facilities from burning gas as a primary energy source. Incremental pricing imposes a complicated rate and accounting mechanism that forces gas pipelines and local distribution companies to pass through to industrial boiler users surcharges on their gas rates. The folly of incremental pricing becomes increasingly apparent at a time of intense competition from imported oil, for which prices are declining dramatically, as well as intense gas-to-gas competition. Both statutes restrict gas demand in the industrial sector and limit the customer base upon which the gas industry can spread fixed system costs.

III.A.

Congress Should Enact S. 1251

A.G.A. strongly endorses S. 1251, introduced by Senators Domenici and Johnston, which repeals FUA and incremental pricing. Indeed, repeal of FUA and incremental pricing could help resolve many of the gas industry's current problems such as increasing take-or-pay obligations. A.G.A. therefore urges this Subcommittee, the full Committee, the Senate and the entire Congress to proceed with maximum speed in its efforts to enact S. 1251. We understand that S. 2205, recently introduced by Subcommittee Chairman Nickles, was intended to repeal incremental pricing as well as the FUA. If S. 2205 is amended to include incremental pricing repeal, as is certainly the case with

Chairman Nickles' bill S. 1302, then S. 2205 too would receive A.G.A.'s enthusiastic support.

III.B.

FUA and Incremental Pricing are Based on Erroneous Economic Assumptions

Congress enacted the FUA and incremental pricing based upon inaccurate and outdated assumptions about the natural gas market. In enacting the FUA in 1978, Congress assumed that the nation's natural gas supplies were declining. Therefore, the FUA was designed to discourage industrial gas use which, in turn, would save remaining gas supplies for residential and other high-priority customers. However, these assumptions since have been proven wrong. Passage of the NGPA in 1978 spurred new gas exploration and production activity in subsequent years. In the 5-year period prior to the enactment of NGPA (1974 to 1978), the amount of gas added to "on the shelf" proven gas reserves in the Lower-48 States was less than half of the amount of gas produced from those reserves. However, in the 5-year period beginning in 1980, after the enactment of the NGPA, additions to gas reserves in the Lower-48 States nearly equalled the amount of gas produced from those reserves. Moreover, in 1985, gas production capability exceeded gas consumption by approximately 2.5 Tcf (gas consumption was slightly under 18 Tcf).

Today, it is recognized that the nation has 50 years of conventional gas resources (*i.e.*, remaining recoverable resources) and hundreds of years of unconventional gas in-place. In short, the nation is not running out of natural gas and restrictions on industrial gas use can no longer be rationalized. Indeed, poor gas demand is a major disincentive to producers already hit hard by declining oil and natural gas prices, and federal tax uncertainty. This disincentive should be removed forthwith.

The economic assumptions upon which incremental pricing are premised have been overtaken by market conditions. In 1978, Congress deemed incremental pricing to be necessary to order the gas market. Incremental pricing was designed to protect price sensitive gas customers by inhibiting pipelines from bidding up the prices for new gas supplies and rolling in this high-priced new gas with their low-priced old gas supplies. Theoretically, the higher prices resulting from "excess bidding" for new gas was imposed on industrial boiler fuel users in the form of a surcharge.5/ Market conditions and state regulatory actions, however, have kept the bidding restraint concept, intended in the legislation, from working at all. Yet, surcharges are frequently being imposed on natural gas, making it less competitive with residual fuel oil.

Actually, Congress recognized very quickly that incremental pricing was a bad idea. It had provided for incremental pricing in two phases: Phase I applied only to

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5/ 124 Cong. Rec. H 13114 (daily ed. Oct. 14, 1978) (remarks of Rep. Dingell).

industrial boiler users, and it is that which remains on the books today; Phase II incremental pricing applied to all other industrial users, and in the NGPA of 1978, its continued applicability was subject to elimination through its rejection by either House of Congress. The House of Representatives indeed rejected Phase II by a 10 to 1 margin.

III.C.

FUA and Incremental Pricing Cause Economic Inefficiencies

Repeal of FUA and incremental pricing would promote economic efficiency, enhance environmental quality and national security as documented by recent studies conducted by the Urban Institute and the National Defense Council. Both of these studies, which have been distributed to the Congress, document the significant economic and environmental costs of the FUA.

III.D.

FUA and Incremental Pricing Preclude Opportunities to Lower Consumer Energy Costs

Repeal of FUA and incremental pricing will help the gas industry to expand its industrial market and reduce take-or-pay obligations, thereby lowering prices to gas and electric customers and also to electric customers via more economic generating capability. Gas prices reflect both gas acquisition costs and fixed costs for building and maintaining the gas transmission and distribution system.

Repeal of incremental pricing would help prevent the gas industry from losing more industrial load because of the inhibiting effect of incremental pricing surcharges in the industrial sector. Indeed, FUA and incremental pricing repeal would give the gas industry the opportunity to expand its industrial customer base. This is because incremental pricing repeal would permit the allocation of fixed system costs to a larger number of customers. This reallocation of costs would lower the price of gas per customer to reflect a lower percentage of fixed system costs. This is especially true given that customers subject to FUA and incremental pricing are often interruptible or have high load profile consumption factors.

Moreover, because of the current surplus in gas deliverability, increased demand resulting from FUA and incremental pricing repeal should not cause gas commodity prices to increase. In fact, repeal of FUA and incremental pricing and the resultant increase in gas use would reduce take-or-pay obligations for untaken gas. As a result, FUA and incremental pricing repeal potentially could lower gas prices to all consumers.

III.E.

FUA Inhibits Use of New Technologies

FUA repeal would encourage the use of new gas utilization technologies in the industrial market, such as gas-fueled combined cycle electric power generation and select use of gas in combination with other fuels, that offer high efficiency and environmental benefits. As we indicated earlier, the FUA was designed to discourage industrial energy consumers from using natural gas. An unfortunate side effect of this policy has been to preclude from entry into the industrial market these important new, highly-efficient technologies.

Natural gas-fueled combined cycle turbines allow electric utilities and other industrial users to generate electricity, but with greater efficiency, substantially shorter construction lead times and lower capital outlays than coal-fired or nuclear powerplants. Combined cycle turbine systems are capable of generating electricity up to 50 percent more efficiently than conventional fossil fuel boiler systems. Prepackaged combined cycle systems can be brought on line in 1 to 4 years, while coal-fired or nuclear powerplants are typically brought on line in 8 to 15 years. Finally, combined cycle systems can be built at one-third the capital cost per kilowatt of coal-based capacity and at one-fifth the capital cost per kilowatt of nuclear capacity. Combined cycle turbine systems also are more environmentally benign than steam generating stations. Combined cycle units can be used in conjunction with and can upgrade coal facilities, but FUA restrictions prevent plant operators from making the most economic choice.

Select use of gas (or "select use") in combination with coal, oil or other fuels, as a method of reducing emissions, is another important gas utilization technology that is inhibited by FUA. Natural gas combustion contains virtually no sulfur dioxide or particulates, and far less nitrogen oxides, nonmethane hydrocarbons and carbon monoxide than comparable combustion of other fossil fuels. Greater utilization of select use technology could help reduce sulfur oxides and nitrogen oxides which many believe to be the major contributors to the acid rain problem. However, by discouraging gas use in industrial applications, the FUA inhibits the development of select use technology, which is capable of removing sulfur at $120/ton, one-eighth the cost of a scrubber.

III.F.

Incremental Pricing Encourages Reliance on Imported Oil

Incremental pricing encourages greater reliance upon imported oil, particularly in light of declining oil prices. In the past, incremental pricing surcharges generally have boosted the price of natural gas to rough parity with the price of No.6 fuel oil. Thus, industrial energy consumers using oil as a boiler fuel were discouraged from switching to natural gas. Today, the posted incremental pricing price has not kept pace with the market due to regulatory implementation and administrative lag, resulting in load loss to oil.

Declining oil prices merely exacerbate the problem of oil import dependence. Since incremental pricing surcharges are calculated based upon oil prices that are 30 to 60 days old, gas prices cannot respond immediately to currently declining oil prices. Thus, incremental pricing could cause gas customers to switch to oil, fostering greater reliance on imported oil.

Natural gas is a readily available, domestic energy source. Our nation's energy supply security would be enhanced if incremental pricing were repealed, removing the disincentive against switching from imported oil to gas.

III.G.

Incremental Pricing Distorts Market Preferences

Incremental pricing also unnecessarily distorts market preferences for industrial gas consumers. Incremental pricing surcharges are imposed only on gas acquired by interstate pipelines. Gas transported on behalf of industrial users and intrastate gas are not directly affected. Incremental pricing therefore provides an artificial incentive for industrial boiler fuel users to choose transportation over pipeline system sales. These incentives disrupt the market because they are motivated purely on the desire to avoid incremental pricing surcharges rather than on market preferences.

For these reasons, A.G.A. strongly urges Congress to repeal FUA and incremental pricing. Removal of these artificial restraints on industrial gas use will restore true competition between fuels and benefit all consumers.

CONCLUSION

The legislative steps that we are proposing are highly beneficial to natural gas consumers, as well as to the nation's economic, security and environmental goals, and to all segments of the natural gas industry. Accordingly Mr. Chairman, we compliment you on holding these hearings and we are hopeful that the Subcommittee will move expeditiously to implement our recommendations.

TABLE 1

COMPANIES FILING FOR ORDER 436 BLANKET CERTIFICATE

	Docket No.	Date Filed	Date of Order
1. Gas Gathering Corp	CP86-129	11/01/85	12/05/85
2. Valley Gas Transmission	CP86-171	11/05/85	11/29/85
3. Mid Louisiana Gas	CP86-214	11/26/85	02/11/86
4. Columbia Gulf Transmission	CP86-239	12/13/85	02/25/86
5. Columbia Gas Transmission	CP86-240	12/13/85	02/28/86
6. Ozark Gas Transmission System	CP86-250	12/24/85	Pending
7. Gas Transport, Inc.	CP86-291	01/24/86	Pending
8. Valero Interstate Transmission	CP86-300	01/30/86	Pending
9. Consolidated Gas Transmission	CP86-311	02/10/86	Pending
10. Erie Pipeline System	CP86-330	02/14/86	Pending
11. Transylvania Gas Pipeline	CP86-334	02/14/86	Pending
12. Seagull Interstate	CP86-364	03/07/86	Pending
13. Texas Eastern Transmission	CP86-379	03/13/86	Pending
14. Superior Offshore Pipeline	CP86-387	03/17/86	Pending
15. Northern Border Pipeline	CP86-395	03/19/86	Pending
16. Transco Offshore Gathering	CP86-397	03/20/86	Pending
17. Transcontinental Gas Pipe Line	CP86-405	03/28/86	Pending

Note:

a) El Paso Natural Gas intends to file for a blanket certificate in accordance with Order 436 upon FERC approval of El Paso's offer of settlement, filed March 21, 1986.

b) Transwestern will file for a blanket certificate as soon as a settlement between Transwestern and its customers is approved by FERC. The settlement was filed with the Commission on January 16 and was certified to the Commission as uncontested on March 24, 1986.

4/2/86

AGA American Gas Association

Planning & Analysis
Issues

Issue Brief 86-8 March 7, 1986

TAKE OR PAY PAYMENTS AND OBLIGATIONS

Background

The issue of take or pay payments and take or pay liability has been a focal point of debate in the regulatory and legislative arenas. Some parties have claimed that the take or pay problem has been solved; while others see it as the principal problem impacting gas markets today. In the past, take or pay issues have been "settled" (postponed) through waivers, trading take or pay relief for access and payments. The ability to continue these terms of accommodation has been severely curtailed by rapidly falling oil prices and Order 436. The stated reluctance of interstate pipelines to participate in Order 436 transportation as well as the imbalance in the price of system gas at $2.43/MMBtu (interstate pipeline WACOG's) and spot market gas ($1.80-$2.00/MMBtu) have been attributed to take or pay requirements in high priced contracts. The purpose of this issue paper is to quantify the take or pay problem -- historical, current, and projected.

Results

Take or pay payments (pre-payments for gas under contract not taken) by interstate pipeline have increased substantially from $51.6 million in 1977 to $1.148 billion in 1984 as reported in Statistics of Interstate Natural Gas Pipeline Companies, EIA (Figure 1). While this latter number is large relative to the total annual purchases of domestic gas by interstate pipelines (estimated at 8.4 Tcf in current PGA's), potential liability for untaken gas has increased at a much greater rate.

As reflected in the analysis and assuming all deliverability to be subject to take or pay, based on contracted-for proved reserves and historical reserve to deliverability ratios, interstate pipeline obligations for untaken gas probably reached $4.95 billion in 1985. In 1986, given the sharp decline in oil and spot market gas prices, as well as the projected purchase volumes in filed PGA's, this liability (exposure) could jump to $7.29 billion (Figure 2).

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- Interstate pipeline proved domestic reserves under contract have remained relatively stable in the 1980's -- declining only 5.6% from 83.6 Tcf in 1981 to 79.9 Tcf in 1984 (see Table 2). Over this period production capability (deliverability) -- the criteria upon which take or pay is most often based -- has remained absolutely flat (11.0 Tcf in 1981 and 11.1 Tcf estimated in 1986). As a result of a number of factors, including in-fill drilling, well repacking and other production enhancement techniques, the ability to produce at lower and lower R/P ratios has improved (see Tables 2 and 5).

- During this period of flat deliverability, requirements by interstate pipelines for domestic gas under long-term contracts has declined significantly from 10.9 Tcf in 1980 to an estimated 8.4 Tcf in 1986 (23% decline). See Table 4. The principal reasons for this decline are: (1) a contraction in the size of U.S. gas requirements; and (2) a displacement of systems gas by transported gas. The transported gas does not generally provide a credit for pipelines against take or pay obligations.

- While the precision of the exact extent of the take or pay exposure can be debated -- particularly on the issues of oil price and carriage volume assumptions as well as the extent of take or pay renegotiation/waiver -- the underlying methodology in this analysis is conservative. The analysis uses estimated PGA volumes for 1986 as of PGA's effective January 1, 1986. PGA's on file for the period starting March 1, 1986 estimate annualized volumes of 7.7 Tcf (8.3% lower than the January estimate - potentially affected by seasonal factors). Thus the potential problem appears to be worsening due to effects of the spot market and declining oil prices.

Methodology

The calculation of take or pay payments was based on data for interstate pipelines taken from FERC Forms 2 and 15. The estimate of the dollar amount of interstate obligations for untaken gas was based on a comparison of production capability under contract versus the amount of gas actually taken.

The trends in R/P ratios for long term interstate contracts with producers show a steady increase in production capability (decline in R/P ratio) prior to 1981 when the minimum R/P ratio was recorded. These statistics are shown in Table 1. For this study it was assumed that this decline would continue, increasing the deliverability of the committed reserves. The assumed R/P ratios (indicating a continuation of the historical trend) are tabulated as the Interstate deliverability capability in Table 1. The calculations are based on the declining reserves (assumed to decrease at 0.4 Tcf per year) and the declining reserves to deliverability ratio (assumed to decline at a rate of 0.1

per year). These parameters are the basis for the estimate of "optimal production level" or production capacity listed in Table 5. Actual production is subtracted from the "optimal production level" to determine the quantity of gas which would have been produced but was shut-in for lack of demand. This volume is indicative of take-or-pay obligations (liability) being accrued by interstate pipelines.

This analysis does not consider Canadian take or pay liability: only the domestic U.S. liability is estimated. Nevertheless, take or pay obligations to Canadian producers would increase the dollar and volume levels estimated.

Table 1
Reserves to Production Ratios

Year	All Interstate Actual	All Interstate Capability	Columbia	Panhandle	United
1963	19.4				
1965	18.0				
1967	16.3				
1969	13.6				
1971	11.1				
1973	9.6				
1974	9.1		7.03	8.69	5.36
1975	8.5		6.88	9.66	4.10
1977	8.3		6.47	9.41	3.71
1978	8.2		6.09	8.70	3.84
1979	7.8		6.15	8.78	3.60
1980	7.8		6.50	8.73	3.17
1981	7.7	7.6	6.34	8.05	3.75
1982	8.3	7.5	6.93	10.02	4.58
1983	9.3	7.4	7.45	12.98	6.35
1984	8.1	7.3	6.49	10.92	4.65

SOURCE: *Gas Supplies of Interstate Natural Gas Pipeline Companies 1984*, EIA.

Table 2
Production Calculations (in Tcf)

Year	Reserves at Y.E.	Production Capability	Actual Production	Unused Production[1]
1981	83.6	83.6/7.6 =11.0	10.9	0.1
1982	84.4	84.4/7.5 =11.3	10.2	1.1
1983	83.3	83.3/7.4 =11.3	9.0	2.3
1984	79.9	79.9/7.3 =10.9	9.9	1.0

[1] Insofar as this potential production is under contract, there could be a take-or-pay liability associated with it.

Table 3
Liability Calculations

Maximum liability for 1981-1984 in dollars would be:

1981 ($2.05) (0.1) = $ .21 billion

1982 ($2.60) (1.1) = $2.86 billion

1983 ($2.81) (2.3) = $6.46 billion

1984 ($2.80) (1.0) = $2.80 billion

Table 4
Interstate Supplies Analysis (in Tcf)

Year	Interstate Pipeline Supplies				
	Total	Imports	Company Owned	Long-Term Contracts	Short-Term And Emergency
1980	12.6[1]	1.0[1]	.7[1]	10.9[1]	-
1981	12.8[1]	.8[1]	.6[1]	10.9[1]	.4[1]
1982	11.8[1]	.9[1]	.6[1]	10.2[1]	.1[1]
1983	10.4[1]	.9[1]	.4[1]	9.0[1]	.1[1]
1984	11.2[1]	.8[1]	.4[1]	9.9[1]	.2[1]
Projected					
1985	10.5[2]	.9[3]	.4[4]	9.2	-
1986	9.8[2]	1.1[4]	.3[4]	8.4	-

[1] *Gas Supplies of Interstate Natural Gas Pipelines*, EIA.
[2] *Estimated from Volume of Purchased Natural Gas by Major Interstate Pipelines, Natural Gas Monthly*, EIA.
[3] *Monthly Energy Review*, EIA.
[4] Estimated.

Table 5
Estimate of Future Take or Pay
(Tcf)

Year	Interstate Reserves at Y.E.[1]	Production Capacity[2]	Long-Term Contract Production[3]	Unused Production
1985	79.5	11.0	9.2	1.8
1986	79.1	11.1	8.4	2.7

[1] Assumes average decline in last seven years, i.e., -0.4 Tcf per year.
[2] Assumes R/P = 7.2 in 1985 and 7.1 in 1986 as maxmimum production capability.
[3] As derived in Table 4.

Table 6
Take or Pay Liability

	Pipeline Reports[1]		Maximum Production Capability	
Year	Gas Prepayments (Million $)	Undelivered Gas (Bcf)	Gas Volumes (Tcf)	Gas Costs (Millions $)
1977	$ 51.6	160.3	As reported by Pipelines	
1978	$ 69.0	154.1	As reported by Pipelines	
1979	$ 110.9	163.8	As reported by Pipelines	
1980	$ 223.6	499.2	As reported by Pipelines	
1981	$ 346.6	252.5	0.1	$ 210
1982	$ 821.6	450.9	1.1	$2,860
1983	$1,100.6	502.8	2.3	$6,460
1984	$1,148.0	499.5	1.0	$2,800
1985	-	-	1.8	$4,950[2]
1986	-	-	2.7	$7,290[3]

---

[1] Statistics of Interstate Natural Gas Pipeline Companies, EIA.

[2] Price of shut-in gas assumed to be $2.75/Mcf.

[2] Price of shut-in gas assumed to be $2.70/Mcf.

FIGURE 1

ANNUAL TAKE OR PAY PAYMENTS

($ millions)

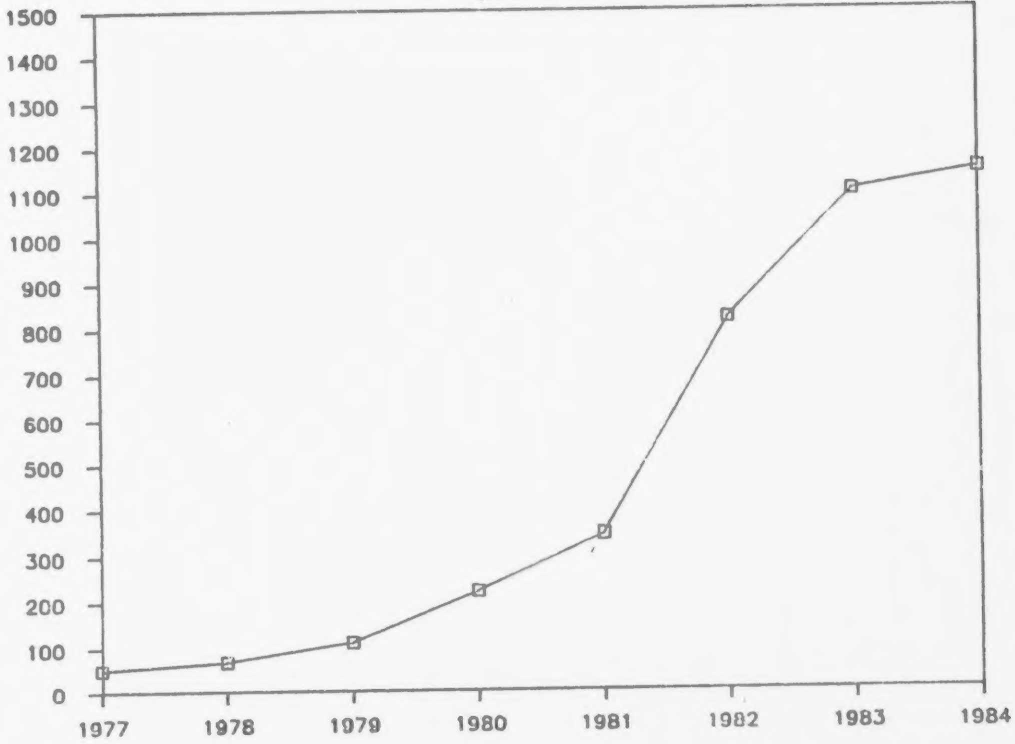
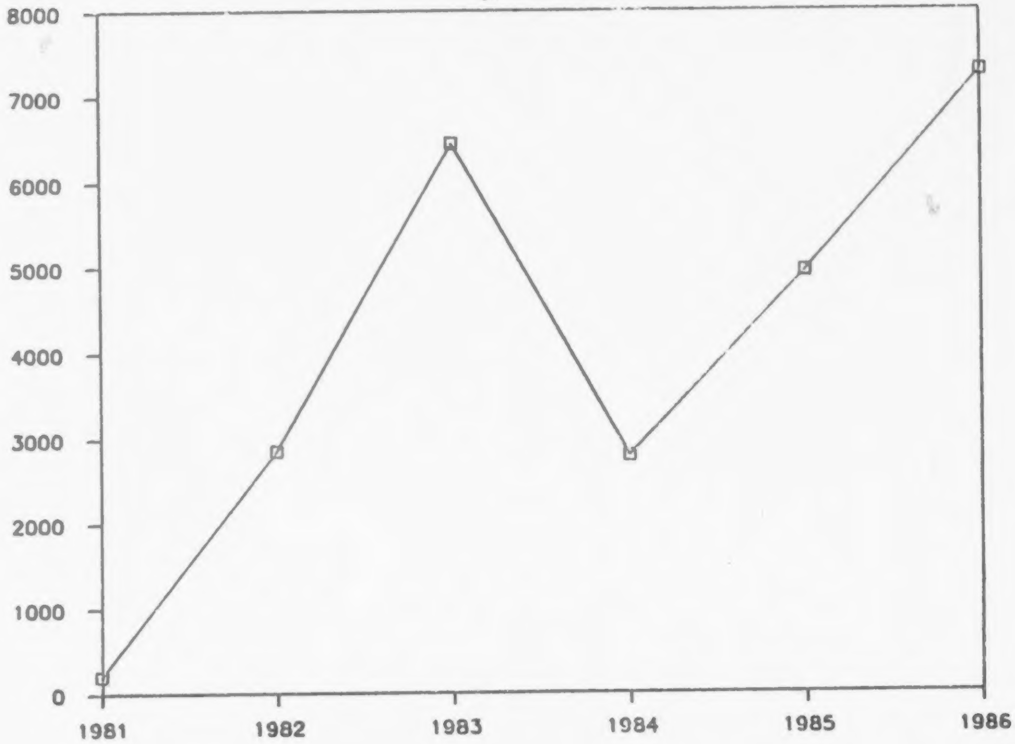


FIGURE 2



POTENTIAL TAKE OR PAY LIABILITY – ANNUAL

($ millions)

Updated Take or Pay Obligations Based on Data From Annual Reports
(in Millions of $)

1985 Settlements	Pipeline Payments	Liability Still Outstanding	Pipeline
64	12.8	177	Coastal
		150[1]	NGPLA
2,100	209	800[1]	Panhandle
166	33.2	700[1]	Trunkline
		700	Southern Natural
22	4.4	2,000	Tennessee Gas
		105	Texas Gas
500	60	572	United Gas Pipeline
		675	Transcontinental Gas PipeLine
13.5	2.7	125	HNG/InterNorth
		123	United Texas[2]
		35[1]	Northwest Central Pipeline
		75[1]	Northwest Pipeline
2,865.5	322.1	6,237	TOTALS

[1] Form 10K Filing.

[2] Intrastate company.

NOTE: Columbia Gas Transmission had deferred $541 million of unrecovered costs related to gas purchases prior to April 1, 1985...taking a $400 million tax loss in 1985. The table does not reflect this liability.

AGA American Gas Association

Planning & Analysis Issues

Issue Brief 86-14 April 11, 1986

ANALYSIS OF A.G.A. LEGISLATIVE APPROACH TO PRICE-CONTROLLED GAS

Introduction

A.G.A. has proposed a method of addressing price-controlled gas (both new and old) in a manner that embraces reduced regulation and greater reliance on market forces. This proposal, which was approved by the A.G.A. Board of Directors, calls for (1) removal of all remaining Natural Gas Policy Act (NGPA) ceilings on new gas (Sections 102d, 103b, 105(b)(3), 107c, 108 and 109), (2) preempting of certain indefinite escalator clauses[1] in existing contracts for new gas (for gas that is deregulated in the previously mentioned sections); and (3) phased removal of ceilings on old gas as existing contracts expire or are renegotiated.

NGPA ceilings on new gas categories still subject to controls are resulting in the price of this gas being roughly twice market levels. By contrast, the price of new gas that was decontrolled on January 1, 1985 has plummeted (see Exhibit 1).

Our analysis indicates that with the current oil price level, decontrol of new gas, along with the phased decontrol upon contract expiration of old gas, could reduce the average interstate pipeline weighted average cost of gas (WACOG) by $0.28 to $0.34/MMBtu by the end of 1986.

Background

Given partial decontrol of new gas on January 1, 1985, the growth of transportation, and the overall instability of energy prices, competition has increased in the energy marketplace. The sudden downturn in oil prices in early 1986 intensified this competition, making it virtually impossible to sell high-cost gas. One indication of this problem is that calculated take or pay obligations of interstate pipelines for untaken supplies of high-cost gas in 1986 could reach $7 billion.[2] Increasing the competitive/take or pay pressure is the continuing gas bubble estimated by A.G.A. at 2.5 trillion cubic feet in 1986.

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In the midst of this market and regulatory chaos, the pressure of rising NGPA price ceilings, which often act as floors, on interstate pipeline WACOGs has intensified. An examination of the trends in gas pricing illustrates the extent to which high cost regulated gas has held WACOGs up. Price-controlled new gas has declined $0.31/MMBtu according to PGA data compiled by Foster Associates since December 1984 -- from $3.78/MMBtu to $3.47/MMBtu by April 1986. In the key section 102d category, average prices declined only $0.09/MMBtu -- from $3.78/MMBtu to $3.69/MMBtu. Decontrolled gas on the other hand, declined $0.87/MMBtu, from $3.97/MMBtu.in December 1984 to $3.10 in April 1986 -- with decontrolled Section 102 gas declining $0.89/MMBtu from $3.79/MMBtu to $2.90/MMBtu. The overall pipeline domestic WACOG declined $0.40/MMBtu, from $2.76/MMBtu to $2.36/MMBtu (see Exhibits 1 and 2). Clearly the failure of the price controlled new gas to move downward as fast as the decontrolled gas prevented the WACOG from declining more rapidly. The solution to the current market imbalance should not focus on old gas but must deal with bringing down the price of non-market responsive, price-controlled new gas (often with the most onerous take or pay obligations).

Methodology

Several studies prepared for A.G.A. by Foster Associates illustrate how much gas would be affected by the A.G.A. approach to decontrolling currently price-controlled gas. One study examined prospective production levels for Sec. 104 and 106 gas by contract termination date.[3] The study estimated that about 6% of old gas production is covered by contracts that will expire in each year from 1986 to 1990. Therefore, decontrolling Sec. 104 and 106 gas upon contract expiration would be a gradual process.

Some currently decontrolled new gas is kept above "free market" levels by contract clauses. In order to determine the type of deregulation clauses present in contracts for currently controlled new gas, Foster Associates examined pricing provisions in Sec. 102d contracts (new gas from old OCS leases).[4] The analysis concluded that 65% of Sec. 102d volumes have clauses that set the deregulated price based on the highest area prices (or an average of the highest area prices) with no market out; or have deregulated prices tied to fuel oil prices or other alternatives with no market out. The analysis indicates that indefinite escalator clauses in Section 102d contracts could take the majority of this gas above market levels upon deregulation. In addition, a large number of contracts have price floors tied to the previously regulated prices. Therefore, in order for the A.G.A. proposal to work -- and allow market forces to operate on the newly deregulated gas -- it is necessary to prohibit the use of certain indefinite escalator clauses and floors tied to NGPA ceilings for the new gas categories that would be decontrolled.

To determine what impact decontrol of currently controlled new gas and old gas would have on pipeline domestic gas costs, A.G.A. analyzed several scenarios for 1986 volumes and prices based on data from Foster Associates.[5] These data reflect pipeline PGA filings and may understate or overstate volumes of gas under contract by various NGPA categories. However, the analysis provides a reliable one-year estimate of the impact of the A.G.A. proposal under the stated assumptions. It should be noted that the maximum consumer benefits from the proposal occur in the first year, while old gas is decontrolled in about 6 percent increments every year for ten years.

Results of Analysis

Our analysis is summarized in Exhibit 3. The WACOG from domestic producers is currently $2.36/MMBtu. If no action is taken this year, and the average refinery acquisition crude oil cost averages $18/bbl in 1986, with high sulfur residual oil at $16/bbl (current average prices), the 1986 interstate WACOG is projected to decline to $2.12/MMBtu (Base Case price). This entire decline would be accounted for by currently decontrolled gas (Section 107, 102c, some 103), which is the gas best able to respond to downward market pressure on gas prices. (For purposes of this projection, currently decontrolled gas is assumed to retain its current ratio vis-a-vis crude oil prices.)

Under the A.G.A. proposal, currently controlled Sec. 102, 103, 105(b)(3), 107, 108 and 109 gas would be decontrolled. Due to the influence of contract pricing terms, there is some uncertainty as to just how far the price of this gas would fall if decontrolled. Therefore, two cases have been estimated.

In the Pessimistic Case we assume that some of this gas, while decontrolled, is kept above "free market" levels by contract clauses (including price floors). These non-market responsive contract clauses were assumed to occur in the same proportion as for decontrolled new gas. Under this scenario, the price of currently controlled new gas would drop to the projected price level of currently decontrolled gas. The WACOG would decline to $1.84/MMBtu.

In the Optimistic Case, we assume that upon decontrol, market forces could cause a decline in the price of currently controlled new gas to a "free market" surrogate price, including severance taxes and gathering charges, of 57% of the crude oil price. With a crude oil price of $18, this free market surrogate price is $1.77/MMBtu. This level, which is used in the current A.G.A.-TERA Base Case, is reflective of the relationship between published spot market, transportation, contract prices and crude oil prices in late 1985 and early 1986.[6] The WACOG under the optimistic proposal would decline to $1.78/MMBtu.

In both cases the slight price rise due to gradual decontrol of old gas would be offset by the reduction in prices of above-market-priced contracts. Again, this is a first year result. The decontrol of old gas in small increments would continue to exert upward pressure on prices over a ten year period.

Conclusion

Our analysis indicates that gas prices (and concomitantly take or pay obligations), would be lower with full decontrol of new gas and phased decontrol of old gas.

---

1. Certain indefinite escalator clauses in existing contracts for new gas deregulated under this proposal would be defused. Specifically, price determination clauses based on other gas prices (favored nation clauses), oil prices or NGPA ceiling prices would be made inoperative. If because of this prohibition, no price determination clause remained in the newly deregulated gas contract and the parties could not agree to new terms, then the seller would be guaranteed access to the nearest major interconnect.

2. A.G.A., Take or Pay Payments and Obligations (Issue Brief 86-8, March 7, 1986).

3. Foster Associates, Inc., Analysis of NGPA Sections 104 and 106 Gas Purchases by Contract Termination Date (August, 1983).

4. Foster Associates, Inc., Deregulated Pricing Provisions in Interstate Natural Gas Contracts Covering Sales of New Gas from Old OCS Leases (April, 1986).

5. Foster Associates, Purchased Gas Costs of Interstate Pipeline Companies (monthly).

6. A.G.A., A.G.A.-TERA Base Case 1986-1 (January 17, 1986).

EXHIBIT 1

TRENDS IN NEW GAS COSTS

($/MMBtu)

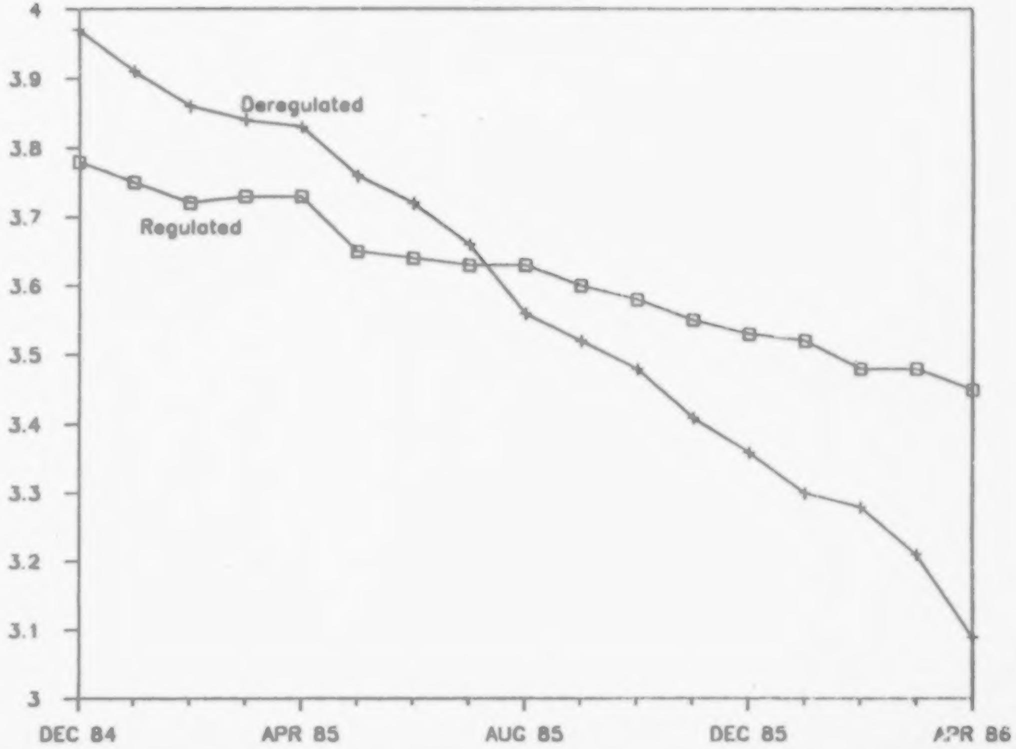

EXHIBIT 2

AVERAGE GAS COSTS BY NGPA CATEGORY

($/MMBTU)

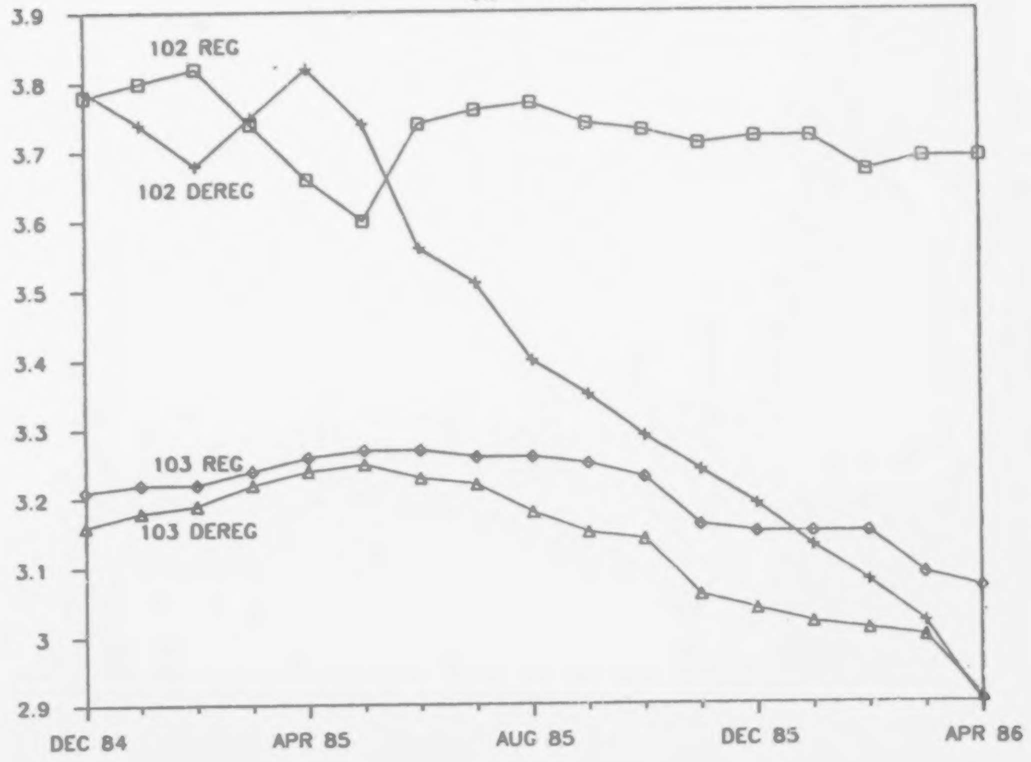

EXHIBIT 3

DECONTROL OF CURRENTLY CONTROLLED GAS

				New 1986 Price	
NGPA Category	April 1986 Volumes (% of Total)	April 1986 Price ($/MMBtu)	Base Case 1986 Price[1]	Pessi- mistic[2]	Opti- misti
CURRENTLY DECONTROLLED					
102	20%	$2.90	$2.08	$2.08	$2.08
103	7	2.91	2.02	2.02	2.02
107	5	4.17	2.85	2.85	2.85
(Subtotal)		(3.10)	(2.19)	(2.19)	(2.19
CURRENTLY CONTROLLED					
102	10%	$3.69	3.69	2.08	1.77
103	5	3.07	3.07	2.02	1.77
107	2	3.30	3.30	2.08	1.77
108	3	3.76	3.76	2.08	1.77
(Subtotal-Controlled New)		(3.50)	(3.50)	(2.06)	(1.77
104/106	38%	$1.39	1.44	1.46	1.46
(Subtotal-Controlled)		(2.12)	(2.15)	(1.67)	(1.57
OTHER	10%	1.66	1.70	1.70	1.70
DOMESTIC WACOG	100%	2.36	2.12	1.84	1.78

GENERAL ASSUMPTIONS:
Refinery acquisition crude oil cost at $18/bbl ($3.10/MMBtu) in 1986; 1985-1986 inflation of 3.3%.

[1] BASE CASE 1986 PRICES WITH $18/bbl OIL: (no new gas decontrol)
Currently decontrolled gas in same proportion to crude as in 1985. Controlled Section 104/106 gas escalated at inflation rate. All other controlled gas held constant. "Other" gas escalated at inflation except warranty gas held constant.

1986 PRICE RESPONSE TO NEW GAS DECONTROL:

[2] Pessimistic Case (contract clauses hold prices above free market price)
Section 102, 107 and 108 controlled price goes to Section 102 decontrolled price.
Section 103 controlled price goes to Section 103 decontrolled price.
Section 104/106 controlled price: 6% rises to market level (57% of Crude); 94% unaffected.

[3] Optimistic Case (achieves free market price)
Section 102, 103, 107 and 108 controlled price = 57% of Crude oil price
Section 104/106 controlled price same as for pessimistic case.

Senator NICKLES. Mr. Lawrence, thank you very much.

Our next panelist is Jerome J. McGrath, president, Interstate Natural Gas Association of America.

STATEMENT OF JEROME J. McGRATH, PRESIDENT, INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA

Mr. McGRATH. Thank you, Mr. Chairman, Senator Ford. I am Jerome McGrath, president of the Interstate Natural Gas Association of America.

Our association represents virtually all of the major interstate natural gas transmission companies operating in the United States.

I would like to summarize briefly, first, our position. We do support the decontrol of old gas as provided for in your bill, S. 1302, provided it is modified to address take-or-pay in nonmarket responsive contracts.

INGA strongly supports S. 2205, repealing the gas use limitations embodied in the Fuel Use Act. INGA also supports S. 1251, which, in addition to repealing the Fuel Use Act, would repeal the unfair pricing provisions of title 2 of the NGPA, and third, the Department of Energy proposal, S. 2285, in our view is seriously flawed and does not in any way address the critical contract problems facing the industry today.

INGA strongly believes that comprehensive legislation addressing all problem areas, including old gas, take-or-pay high-cost contracts, and transportation access is sorely needed.

As the natural gas pipeline industry has been systematically transformed to a more competitive environment at both the sales and supply ends of the pipeline, two significant barriers have prevented a smoother, quicker, and more complete transition.

First, is the existence of rigid gas purchase contracts with regulated and deregulated prices above market clearing levels. The second is the existence of low regulated prices for much of the industry's supply.

The problem has been how to make all of these contract prices market responsive without raising prices to the consumers. We still face this problem and none of the proposals at the FERC or in Congress effectively deal with this problem.

Take-or-pay very clearly is a widespread industry problem and is not limited, as Mr. Nelson suggests, to just one or two pipelines; 12 companies representing 16 pipeline systems, and over 60 percent of the interstate market reported take-or-pay exposure at the end of 1985, of $6.1 billion. By the year 1986, we estimate that the take-or-pay exposure for its member companies will exceed $12 billion, and this is shown in table 2 attached to my testimony.

I might also call the committee's attention, and this is in response to Mr. Nelson's suggestion that the problem is going to disappear—but recently, in Oklahoma, a U.S. district court held Southern Natural Gas Co. liable for its take-or-pay commitments to Challenger Minerals, Inc. Damages being sought are to the tune of $95 million and interest is accruing at the rate of $3.5 million per year.

It is a real, serious, and growing and extant problem as far as our industry is concerned.

Under the new regulatory climate, many producers no longer feel any need to renegotiate. They expect to have access under FERC order 436, and they feel no compulsion to sit down at the bargaining table.

For this reason, we believe that the take-or-pay and the high-cost contract problem must be addressed in any legislation that would deregulate old, low-cost gas. And further, in response to Mr. Nelson, we have not sought abrogation of contracts.

Every proposal that we have discussed and have brought to the Congress and to the Commission has been to give the pipelines incentive—the producers, the pipelines, the distributors, the users, the incentives to sit down at the bargaining table and negotiate the problem contracts.

The argument that old gas decontrol will stimulate renegotiation—the renegotiation process, standing by itself—just doesn't wash, in our opinion.

INGA supports, Mr. Chairman, the thrust of S. 1302, providing, as I said, it is coupled with the mechanism to encourage the renegotiation of our problem contracts.

We believe the contract expiration approach to old gas decontrol is basically fair. Allowing decontrol of renegotiated old contracts is also a concept that INGA can support.

As I indicated, in our view, the administration's bill, S. 2285, is badly flawed, hopelessly one sided, and a threat to the stability of the natural gas industry. The bill would decontrol all gas as of April 1, 1987, an event that would release tremendous upward pressure on average natural gas prices at a time when the industry is already struggling to control costs in order to hold on to market share in the face of plummeting oil prices.

The bill contains absolutely no provision to even assist in the renegotiation of high-priced, high-take contracts. I might also note that section 203, dealing with the area rate clauses, is an abbrogation of contract and that for those contracts that have a much lower price in it, under decontrol, are automatically given a higher price by the last effective rate provision of that bill, which, to me, is abbrogating the contract upward.

Since the subcommittee hearings last November, we have attempted to develop an industry concensus on the legislative approach to deal with both natural gas transportation issues and non-market-sensitive contract issues. We have participated in numerous meetings with producer and distributor groups and other segments of the industry, but have been unable to arrive at a concensus among producers, pipelines, and distributors.

It is still our belief that a straightforward legislative amendment to existing natural gas law, addressing acknowledged issues that I have described, old gas decontrol, access to transportation, and renegotiation of non-market-sensitive contracts is needed. If such comprehensive legislation is not possible in this session of the Congress, we strongly urge that legislation repealing the gas use limitations of the Fuel Use Act and title 2 of the NGPA go forward on a separate, expedited legislative track.

That concludes my statement, Mr. Chairman, and I thank you very much.

[The prepared statement of Mr. McGrath follows; attachments have been retained in subcommittee files:]

STATEMENT OF

JEROME J. MCGRATH

PRESIDENT

INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA

BEFORE THE

SUBCOMMITTEE ON ENERGY REGULATION AND CONSERVATION

COMMITTEE ON ENERGY AND NATURAL RESOURCES

UNITED STATES SENATE

APRIL 15, 1986

Mr. Chairman and Members of the Subcommittee:

I am Jerome J. McGrath, President of the Interstate Natural Gas Association of America (INGAA). I appreciate the opportunity to appear before you today on behalf of INGAA to discuss the important issues facing our member companies and the natural gas industry.

INGAA is a non-profit national trade association representing virtually all of the major interstate natural gas transmission companies operating in the United States. Our member companies are both wholesalers and transporters of natural gas who move gas from producing areas to distributors and end users across the nation. In addition, our members provide extensive natural gas storage services and perform other forms of load balancing functions, and we provide an assured supply of natural gas as required by our service obligations with our customers. Approximately

90 percent of the natural gas transported and sold in interstate commerce flows through more than 200,000 miles of pipeline owned and operated by INGAA member companies.

SUMMARY OF POSITION

1. INGAA would support the decontrol of old gas as provided for in Sen. Nickles' bill, S. 1302, provided it is modified to address onerous take-or-pay and nonmarket-responsive contracts.

2. INGAA strongly supports S. 2205, repealing the gas use limitations embodied in the Fuel Use Act (FUA). INGAA also supports S. 1251, which in addition to repealing the FUA gas use restrictions would also repeal the incremental pricing provisions of Title II of the Natural Gas Policy Act (NGPA).

3. We believe the approach urged by the American Gas Association (AGA) to resolve the problems posed by high take-or-pay and high cost contracts to be a reasonable one, and INGAA supports it.

4. The Department of Energy proposal (S. 2285) is seriously flawed and does not in any way address the critical contract problems facing the industry today.

BACKGROUND

Last November, in testimony submitted by Mr. Peter J. King, Jr.,-immediate past Chairman of INGAA, he described at length the problems facing the industry because of inflexible high cost contracts and the increasingly adverse consequences of mounting take-or-pay obligations in pipeline/producer contracts. He also pointed out the major problems spawned by FERC Order 436 and the difficulties encountered by interstate pipelines in attempting to respond to the open access transportation requirements of that order. Today, over six months later, little has taken place to overcome the major impediments of Order 436 that have caused the majority of the pipelines not to accept the program. For the most part, those companies that have filed for a certificate pursuant to Order 436 have done so only after extensive discussions and settlement agreements with their customers and producers. Adding further to the problems spawned by Order 436 was the U. S. Court of Appeals decision handed down August 20, 1985, affirming the Commission's Order 380, which eliminated, for all practical purposes, minimum bill provisions in pipelines' agreements with their local distribution company customers. Furthermore, as each day passes take-or-pay dollars are increasing, and with the recent dramatic drop in oil prices the competitive posture of the pipelines is even more uncertain than it was last fall.

INGAA strongly believes that comprehensive legislation addressing these problem areas is sorely needed. I would like to discuss each of these in more detail. I would also like to make clear that in the absence of comprehensive legislation, repeal of the Fuel Use Act and incremental pricing under Title II of the NGPA should be considered separately and Congress should act expeditiously to adopt such legislation on a stand-alone basis.

HIGH TAKE-OR-PAY AND HIGH PRICED CONTRACTS REMAIN CRITICAL ISSUES

I would like to review briefly for the Subcommittee the very difficult situation in which the industry finds itself today. The focal point of the marketplace is spot gas, which currently, in some producing areas, is as low as $1.50 per MMBtu, as compared to the most recent weighted average cost of gas (WACOG) of interstate pipelines of $2.44 per MMBtu.1/ Obviously high price contracts remain a problem. Moreover, much gas at even higher wellhead prices is shut-in and take-or-pay obligations are building rapidly because the gas is not marketable.

NONMARKET-RESPONSIVE CONTRACTS

As the natural gas pipeline industry has been systematically transformed to a more competitive environment at both the sales and supply ends of the pipeline, two significant barriers have prevented a smoother, quicker and more complete transition. The first is the existence of rigid gas purchase contracts with regulated and deregulated prices above market clearing levels, and the second is the existence of low regulated prices for much of the industry's gas supply. The problem has been how to make all of these contract prices market responsive without raising prices to the consumer. We still face this problem and none of the proposals at the FERC or in Congress effectively deal with this dilemma.

INGAA's member companies report that only about 28 percent of pipeline purchases of new gas is pursuant to contracts containing market responsive terms. We estimate the average price for this gas was about $2.26 per MMBtu.2/ Another 25 percent of their purchases is for new gas estimated at $4.45 per MMBtu, on average, obviously not responsive to market conditions.3/ The gas under contract and not purchased could easily be at yet a higher price.

To further illustrate the problem with nonmarket-responsive contracts, I have attached a table (Table 1) showing the average prices paid by interstate pipelines to 17 major producers. Although the overall average price paid to these producers is $2.39 per MMBtu, the price paid under new gas contracts (i.e., gas that would fall into Block 2 under the FERC's block billing proposal) averages $3.60, ranging from a high of $4.28 per MMBtu for Amoco to a low of $3.14 per MMBtu for Phillips. These new gas prices, which include both market-responsive and nonmarket-responsive new gas contracts, exceed current market prices by $1 to $2 per MMBtu. Thus, while many would have you believe that producers would be agreeable to pricing gas at market levels and while many advocate increasing old gas prices to current market prices, these producers clearly have not yet responded to market pressures. This table should dispel any doubt that high price gas is a critical issue in the natural gas industry today.

There is a widespread impression that all old gas is priced below market levels. It is true that 34 percent of pipeline purchases is at an average price of $.92/MMBtu, a price that is about one dollar below average spot prices.[4] The Subcommittee should be aware, however, that substantial volumes of old gas are in fact already above market clearing levels. Eleven percent of pipeline purchases is old gas priced at an average of $2.55 per MMBtu.[5] Not only is this price more than 50 cents above spot prices but it is also above the average price paid for market-responsive gas, $2.26 per MMBtu.

Thus, we are faced with a large portion of our supply that is above market clearing levels; this includes both old gas, nonmarket-responsive new gas and some 2 percent other. We also have a large portion of our supply priced below market levels. All of these prices are the result of outmoded regulations and outdated market conditions. The problem contracts for both low and high prices must be resolved simultaneously -- one part of the problem cannot be fixed without fixing the other. You cannot raise old gas prices without providing a mechanism for lowering high gas prices.

TAKE-OR-PAY

As you have heard before and as you are hearing again this morning, there is disagreement over the extent of the take-or-pay problem facing our member companies. It is our conviction that the problem is very serious. It has three facets:

1. It is an industry-wide problem.

2. Exposure is in the billions of dollars, and growing, and

3. Although there have been some settlements in the past, the new rules under which the pipelines must now operate make settlement extremely difficult.

Take-or-pay is clearly a widespread industry problem and is not limited to just one or two pipelines. At least 12 companies have cited take-or-pay as being a major problem in their current (1985) 10-Ks or annual reports. These 12 companies, representing 16 pipeline systems and over 60 percent of the interstate market, reported take-or-pay exposure at the end of 1985 of $6.1 billion.

More significant than this, however, is the rapid rate at which the take-or-pay problem is growing. Compounding the problem is the current shifting away from gas to oil by many large users as a result of the sharp drop in oil prices.

INGAA's member companies reported in a recent survey that they expect their take-or-pay exposure to more than double in 1986. Thus, by year-end 1986, INGAA estimates the take-or-pay exposure for its member companies will exceed $12 billion. These data make it abundantly clear that take-or-pay is a multibillion-dollar problem that must be resolved as we move toward open access transportation and try to reconcile outmoded gas prices to market conditions.

Assertions have been made that the problem will solve itself -- that producers, somehow, will agree to renegotiate these take-or-pay and high cost contracts. This may have been true at a time last year when pipelines could still offer transportation in exchange for settlement. The fact is, however, that under the new regulatory climate many producers no longer feel any need to renegotiate. They expect to have access under Order 436 and they feel no compulsion to sit down at the bargaining table.

This attitude was well illustrated in this very room last November, following Order 436, when, in response to a direct question, five producers said they would not exchange take-or-pay relief for access to pipeline transportation.

Thus we believe that the take-or-pay and high cost contract problem must be addressed in any legislation that would deregulate old, low cost gas.

LEGISLATION PENDING BEFORE THE SUBCOMMITTEE

S. 1302, S. 1251, S. 2205

INGAA supports completely the thrust of S. 1302, providing it is coupled with a mechanism to encourage the renegotiation of high price, high take-or-pay contracts. We believe the contract expiration approach to old gas decontrol is basically fair. The provision allowing the renegotiation of such old gas contracts is also a concept that INGAA can support.

The general thrust of the pricing provisions of S. 1302 is that old natural gas is deregulated when contracts expire or are renegotiated. INGAA can support this concept, provided the other contract problems are also addressed. The gradual nature of phased deregulation is what makes this proposition workable. I would like to note, however, that section 121(f)(5) of S. 1302 would appear to force immediate deregulation of life-of-lease contracts, whereas long term contracts would remain in effect at regulated prices for their full term unless the parties mutually agree otherwise. As written, section 121(f)(5) would undercut the gradual deregulation otherwise intended by the bill, and we recommend that this provision be deleted.

INGAA is in agreement with the other provisions of S. 1302, particularly those repealing portions of the Fuel Use Act and incremental pricing (Title II of the NGPA). It is long past time to let the marketplace, and not an outdated statute, determine the type of fuel to be used in any given application.

We believe such action would not only foster the increased use of natural gas but it would also be in harmony with the concept of select use of natural gas for clean air compliance. INGAA believes that the marketplace should determine the technology to be used when complying with environmental emissions standards for controlling acid rain. Should Congress mandate that specific technologies, such as scrubbers, be required as the means of reducing emissions from coal-fired plants, the Congress would not only be placing short-sighted limits on potential natural gas markets but would also be reducing the economic viability of coal-fired plants. Thus, a policy of "free economic choice" for compliance with air quality standards could result in increased use of both natural gas and coal. Repeal of FUA restrictions on gas is a needed step to further this policy.

Incremental pricing is another anachronism that no longer serves any useful purpose. In fact, it acts as a potential roadblock to full utilization of natural gas for industrial fuel. Congress recognized the misguided effect of incremental pricing when in 1980 the House voted against implementation of the second phase of incremental pricing. The time has come to repeal incremental pricing altogether.

If comprehensive, balanced natural gas legislation is not possible this year, INGAA strongly supports moving forward with Fuel Use Act/incremental pricing legislation on a stand alone basis. In our opinion, it is time to move forward on those areas of legislation upon which all segments of the industry agree and stop holding those positive proposals hostage to agreement on other more controversial issues.

Thus INGAA is in full support of S. 1251 and S. 2205, which are directed toward this end.

S. 2285 (Administration Bill)

I would like to turn now to the bill recently proposed by the Administration, S. 2285. In our view, the Administration bill is badly flawed, hopelessly one-sided, and a threat to the stability of the natural gas industry. The bill would decontrol all gas as of April 1, 1987, an event that would release tremendous upward pressure on average natural gas prices at a time when the industry is already struggling to control costs in order to hold on to market share in the face of plummeting oil prices. Yet, incredibly, the bill contains absolutely no provision to even assist in the renegotiation of high price, high take contracts.

Certainly DOE assumes that such renegotiations will occur. But this leap of faith is not justified by experience. As this Subcommittee knows, our industry has been attempting to renegotiate these contracts for years with only limited success. Yet the DOE proposal would grant producers of lower cost gas the right to higher prices in less than a year's time. DOE's apparent assumption that all obstacles to renegotiation will simply melt away defies realty.

Exacerbating this problem further is the area rate provision of the bill. This provision would prop up the prices paid under certain contracts when the removal of controls would otherwise result in a price drop. Apparently the Administration believes that government intervention into the contract process is acceptable when it results in higher prices for producers and higher costs to consumers but opposes such intervention when it could result in lower, market-responsive prices.

As for the carriage provisions of the bill, I do wish to point out one important shortcoming. The bill contains the unworkable legal standard of mandating transportation "without discrimination" when the appropriate legal standard under the Natural Gas Act and other similar statutes has always been "without undue discrimination," or words to that effect.[7/]

The strict "without discrimination" language could render illegal such common practices as volume discounts, mileage sensitive rates, zones of reasonable rates, the first come, first served standard of Order 436, and other efforts to tailor carriage service to the needs of individual customers. It is exactly for reasons such as these that Congress has consistently recognized that the appropriate legal standard should be "undue discrimination." Similar language must be included in the DOE bill to give FERC the flexibility it would need to implement this carriage provision, should it be enacted.

FEDERAL ENERGY REGULATORY COMMISSION DOCKET NO. RM86-3

INGAA strongly opposes the DOE proposal now pending before the Commission. The proposal would raise old gas prices to the proposed ceiling price of $2.54 per MMBtu without any corresponding reduction in high gas prices. The proposal would trigger area rate clauses, which are contained in 90 percent of the existing old gas contracts, and the so called "good faith negotiation rule" would be totally ineffective as proposed.

INGAA'S POSITION

INGAA concluded last November that a legislative alternative would be the best way to address the critical contract problem facing the industry. The continued unwillingness of the FERC to address the take-or-pay issue, along with the lack of successful, widespread contract renegotiation with producers, has reinforced our view. We are disappointed that the Department of Energy has also turned a blind eye toward the pipelines' concerns.

Since the Subcommittee hearings last November, we have attempted to develop an industry consensus on a legislative approach to deal with both natural gas transportation issues and nonmarket-sensitive contract issues. We participated in numerous meetings with producer and distributor groups and other segments of the industry and believed some initial progress had been made. However, when the DOE recently came forward with its proposed legislation the producer group elected to defer their participation in further discussions. Thus we have been unable to arrive at a consensus among producers, pipelines and distributors.

It is still our belief that a straightforward legislative amendment to existing natural gas law addressing the acknowledged issues of old gas decontrol, access to transportation and renegotiation of nonmarket-sensitive contracts is needed.

INGAA has indicated a willingness to listen to any proposed legislative solution that addresses these issues and fairly balances the interests of consumers, distributors and producers as well as pipelines. INGAA does not believe that any of the legislative pricing proposals put forward to date in Congress provide this balance. Proposals that only raise the price of low-priced old gas without lowering the price of high-priced gas are simply not rational at a time when the pipeline industry is struggling to lower costs in order to maintain markets. The problem is how to make outmoded contract terms and conditions, in both low- and high-priced gas contracts, workable in today's market. INGAA has told all parties with which it has held discussions that our primary goal in any legislative effort was to insure incentives for all parties to renegotiate nonmarket-sensitive contracts.

In its comments regarding Order 436 and in its pursuit of an industry consensus for a legislative alternative, INGAA proposed what has been labeled "conditioned access." Under this approach a producer's access to a pipeline's transportation services depends upon the producer first agreeing to renegotiate its high-price/high-take contracts with the pipeline. INGAA's approach was based on the success of the now defunct FERC Special Marketing Program (SMP). This experimental program demonstrated that conditioned access could work to bring about renegotiation of problem contracts. Even though relatively small volumes were transported under the SMPs, the pipelines were able to achieve $1.3 billion in take-or-pay relief. Based on this success, it was INGAA's belief that "conditioned access" could provide some incentive for renegotiation. Unfortunately, INGAA has found little support within the industry for this approach.

Recently the AGA has put forward a new proposal for addressing pricing and contract issues. This proposal would decontrol all gas but tie decontrol of new gas to the neutralization of IPE clauses in new gas contracts, thus encouraging a renegotiation of such contracts to market levels. I understand that AGA will explain its proposal in detail in their testimony before the Committee. INGAA believes that the AGA approach is a reasonable, albeit only a partial, solution to the dilemma I have outlined, because it would not assure the renegotiation of all nonmarket-sensitive contracts. We join in supporting the AGA recommendation and we urge the Subcommittee and other segments of the industry to consider it carefully.

CONCLUSION

To summarize INGAA's position, we commend the chairman for his legislative proposal, S. 1302. Deregulation of expired and expiring contracts, as well as renegotiated contracts, is the best way to deal with old gas pricing. However, such legislation must be coupled with provisions addressing the critical take-or-pay and high-cost contract problems facing the industry if consumers are truly to be protected against higher gas costs.

If such comprehensive legislation is not possible in this session of the Congress, we strongly urge legislation repealing the gas use limitations of the FUA and Title II of the NGPA on a separate, expedited legislative track. Specifically, we endorse enactment of S. 2205 and/or S. 1251 at the earliest possible date.

That concludes my statement, Mr. Chairman, and I would be pleased to answer the Subcommittee's questions.

FOOTNOTES

1. Recent PGAs filed at FERC as reported in Foster Associates, Current Purchased Gas Costs of Interstate Pipelines, updated March 27, 1986.

2. Estimates based on the source referenced in footnote 1 and INGAA survey data.

3. *Id.*

4. *Id.*

5. *Id.*

6. These data are summarized in Table 2, which is attached along with relevant pages from the 10-Ks and annual reports.

7. See, for example, Federal Power Act (16 U.S.C. sec. 824d(b)): "no utility shall...make or grant undue preference...or subject any person to undue prejudice or disadvantage...." and (16 U.S.C. sec. 824e(a)): rates are not to be "unjust, unreasonable, unduly discriminatory or preferential...."; Interstate Commerce Act (49 U.S.C. sec. 13(4)): "...any undue, unreasonable, or unjust discrimination...."; Communications Act of 1934 (47 U.S.C. sec. 202(a)): "It shall be unlawful for any common carrier to make any unjust or unreasonable discrimination...."

TABLE 1

AVERAGE NEW AND HIGH COST GAS PRICES BY INDICATED PRODUCERS

Producer	Overall Average Prices (including Old Gas) ($/MMBtu)	Average New and High High Cost Gas Price Received* ($/MMBtu)
Amoco	2.82	4.28
Union Oil	2.38	4.17
Conoco	2.58	3.86
Texas Gas Exploration	2.83	3.76
Shell	2.64	3.73
Exxon	2.69	3.69
Mobil	2.43	3.64
Diamond Shamrock	2.69	3.49
Chevron	1.83	3.48
Texaco/Getty	2.37	3.47
Champlin Petroleum	2.46	3.39
Marathon	2.52	3.38
Sun	2.49	3.37
Arco	2.47	3.27
Tenneco Oil	2.42	3.24
Cities Services	1.87	3.17
Phillips	2.00	3.14
Average	2.39	3.60

* Sections 102, 103, 105, 106(b), 107 & 108

NOTE: Actual annualized prices from pipeline PGAs filed second half of 1985 as contained in EIA PGA data base (March, 1986, unpublished).

TABLE 2

TAKE-OR-PAY EXPOSURE AS OF 12/31/85
(According to 10-Ks)

Name	Exposure ($Million)	Page in 10-K
Coastal Corporation[1/]	177	34[2/]
HNG/Internorth[3/]	125	48[2/]
Natural Gas Pipeline	150	11[4/]
Northwest	75	28
Northwest Central	35	26, 27
Panhandle Eastern	800	F-22, 23
Southern	700	37, 38[2/]
Tenneco	2,000	39-41
Texas Gas (CSX)	105	38, 39[2/]
Transco	675	43-45
Trunkline	700	F-12, 13
United Energy[5/]	572	39[2/]
TOTAL	6,114	

1/ Includes ANR Pipeline and Colorado Interstate.

2/ Refers to annual report.

3/ Includes Florida Gas Transmission, Northern Natural, and Transwestern.

4/ Refers to pipeline's 10-Q. For year ending 9/30/85.

5/ Includes United Gas Transmission and Sea Robin. For Year ending 9/30/85.

Source: INGAA Survey of Member Companies.

Senator NICKLES. Thank you, very much. Our next panelist is Jim Harlow, chairman and president of Oklahoma Gas & Electric Co.

STATEMENT OF JAMES G. HARLOW, JR., CHAIRMAN OF THE BOARD AND PRESIDENT, OKLAHOMA GAS & ELECTRIC CO.

Mr. HARLOW. Thank you, very much, Mr. Chairman. I would like to make a few comments about the Fuel Use Act, especially. Our company serves electricity to central Oklahoma and western Arkansas.

We appreciate your having hearings on these issues relating to the Fuel Use Act. I am going to address myself largely just to baseload plants, and their prohibition to use gas if we construct new ones.

As the rules now stand, virtually in the electric utility business, baseload, we can generally just produce a coal plant--the way the rules are. Nuclear is pretty much eliminated due to costs, and so forth. Oil, in pricing instability; and, of course, gas, due to the Fuel Use Act.

Oklahoma Gas & Electric Co. is now 50 percent gas and 50 percent coal. As recently as 10 years ago, we were 100 percent natural gas.

As you are aware, the gas and oil industry is very depressed in our region and we feel that new gas plants would be an advantage to that industry. Briefly speaking, the advantage to a company such as ours in building new baseload gas plants would be as follows:

First, it takes about one-third the time to site and build a gas plant as it does a coal unit. This is an advantage in cases where we are not too sure about the load growth so that you could actually build it quicker. That kind of unit has about half the cost of a coal unit.

For instance, a 500-megawatt gas-burning facility, over 10 years, would save between $350 and $450 million, or about $35 to $45 million a year in costs. We could stand a pretty large increase in gas price from today's market and still be competitive with coal, considering the capital costs.

Spot market gas, as you know today, is down to $1.50 to $1.40 regional, and, of course, we could pay substantially greater than that and still be having an advantage of building gas units.

A gas unit like that would use about 25 billion cubic feet a year, and would provide $60 to $80 billion to our economy in Oklahoma in terms of burning more gas. Listening to the rest of the discussion this morning, I believe that it would be an advantage to deal with just the Fuel Use Act, if that was all that legislatively could be moved and give us the right to make the decision on which fuel to use based on availability, cost, and economic concerns such as that.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Harlow follows:]

ENERGY REGULATION AND CONSERVATION SUBCOMMITTEE
UNITED STATES SENATE

April 15, 1986

Powerplant and Industrial Fuel Use Act Testimony
James G Harlow, Jr
Chairman of the Board and President
Oklahoma Gas and Electric Company

Mr Chairman and Committee Members, I am James G Harlow, Jr, Chairman of the Board and President of Oklahoma Gas and Electric Company.

Oklahoma Gas and Electric Company, the largest electric utility in Oklahoma, owns and operates an interconnected electric production, transmission and distribution system. The system includes eight generating stations with a total capability of 5,655,300 kilowatts. The fuel mix of our powerplant boilers is about 50 percent natural gas and about 50 percent coal. The Company, an investor-owned utility, furnishes retail electric service in 269 communities in Oklahoma and western Arkansas. The Company also provides wholesale electric service to 14 communities and 3 rural electric cooperatives. At the end of December 1985, more than 645,000 customers received electricity from Oklahoma Gas and Electric Company. Aproximately 1,600,000 people reside within Oklahoma Gas and Electric Company's 30,000 square mile service area which includes Oklahoma City, the largest city in Oklahoma and the location of the Company's corporate offices and Fort Smith, the second largest city in Arkansas.

I want to commend this committee for giving consideration to amendments to the Powerplant and Industrial Fuel Use Act of 1978. The amendments I am recommending relate to baseload powerplants which you know are those which are designed to operate essentially around the clock throughout the year as opposed to a peak load unit which can be operated only 1500 hours a year or less. I realize that this committee is looking at other energy legislation, but I want to direct my remarks primarily at amendments to the Fuel Use Act which would allow the construction of new natural gas-fired electric powerplants.

At present, the electric utilities have essentially only one alternative in meeting the baseload electrical generating needs for the future. I say only one alternative because a utility would not construct a nuclear plant due to financial risks and a natural gas-fired plant cannot be built because of the Fuel Use Act. Therefore, a coal-fired plant is the only baseload plant that can be constructed at this time. Coal plants are substantially higher in cost as compared to a gas-fired plant and take approximately three times longer to build. The electric utility industry definitely needs the natural gas option in order to provide the quickest, most reliable and inexpensive baseload power available.

You know that the oil and gas producing states are very depressed at this time due not only to the falling price of oil but also to the oversupply of natural gas and you are also aware that this condition has dominoed into bank failures and bankruptcies of energy related businesses.

Amendments to the Fuel Use Act to allow construction of new gas-fired generating units will be a tremendous benefit in helping to restore economic health to the oil and gas producing states with no adverse impact on other states that I can envision.

Amending the Fuel Use Act would also have environmental benefits. In recent years there has been much debate over whether sulfur dioxide emissions from coal-fired powerplants have caused acidic deposition (acid rain) in the northeastern part of the United States and Canada. President Reagan has announced an agreement with Canada for a $5 billion program to reduce sulfur dioxide emissions. He has stated that $2.5 billion of the acid rain program would be provided by industry which would average $50 million dollars for industry per state. New natural gas electric generating plants built as a result of amendments to the Fuel Use Act would not emit sulfur dioxide and, therefore, would not further aggravate any acid rain problems.

Possibly, the most important reason to amend the Fuel Use Act is because natural gas-fired plants are approximately half the cost of coal plants which will result in lower electric rates to the consumer. To illustrate the cost savings to consumers, consider the following statistics:

In making these projections of cost savings, I have assumed Oklahoma Gas and Electric Company's current cost of fuel will remain at approximately the same ratio of gas to coal through 1996, which is approximately 2 to 1. Also, it is assumed that the capital cost (excluding carrying costs) is at a ratio of 1.88 to 1 for a coal plant versus a gas plant.

- The dollar savings to the customers over a 10-year period from 1987 through 1996 for one single 500 megawatt combined-cycle gas-fired unit versus a coal-fired unit would be $368 million at a 65 percent capacity factor or $453 million at a 50 percent capacity factor. The capacity factor is the percent of time that the plant is operating at maximum capacity and the typical utility in our region is in the 50 to 70 percent range.

- Because of the higher capital costs of a coal-fired generating unit as compared to a gas-fired unit (and assuming current costs of coal delivered to the plant of $1.61/mmbtu) one could pay as much as $4.08/mmbtu for gas at a 65 percent capacity factor and retain the cost savings over a coal plant. Recently, gas purchased on the spot market in Oklahoma has been as low as $1.40/mmbtu, which allows for a substantial range up to the $4.08/mmbtu in order for gas to remain more economical than coal.

- Savings to the ratepayers are estimated to be between $37 and $45 million annually for each and every 500 megawatt gas-fired baseload unit as compared to a 500 megawatt coal-fired unit with scrubbers. Oklahoma Gas and Electric Company has completed 5 coal-fired units in the last 10 years and 11 coal-fired units have been built in Oklahoma in the last 10 years.

- Gas prices in the future could rise to near 2.53 times the delivered cost of coal and still be economical.

- Each 500 megawatt gas-fired electric generating unit will burn approximately 20 to 25 billion cubic feet of gas annually. In 1987 this would represent between $64 and $83 million in gas purchases which would help restore economic growth to oil and gas producing states.

For these reasons I urge you to amend the Fuel Use Act so that gas may be burned in new electric generating stations. I certainly appreciate the opportunity to provide information on this important topic and will be happy to respond to any questions.

Senator **Nickles**. Thank you for your comments. Our next panelist is Andy Merrels, Hydrocarbon Ventures, Owens-Corning Fiberglas, from Toledo.

STATEMENT OF A.S. MERRELS, DIRECTOR, ENERGY PURCHASING AND HYDROCARBON VENTURES, OWENS-CORNING FIBERGLAS CORP., ON BEHALF OF THE PROCESS GAS CONSUMERS GROUP

Mr. **Merrels**. Thank you, Mr. Chairman. I am also here as chairman of the Process Gas Consumers Group.

The problem in today's gas market is that, notwithstanding falling oil prices, pipelines continue to purchase expensive gas even when their own sales rates are higher than a free marketplace would permit.

This situation is made worse by significant barriers which prevent producers from selling and end users from buying lower priced supplies.

PGC believes that the interest of all the industry—producers, pipelines, distributors, and end users—will best be served by making the purchase, sale, and transportation of natural gas as market oriented as possible.

Any legislative proposal must recognize and deal with the realities of today's gas market. Peacemeal tinkering with only one industry segment's perceived difficulties will continue the problem and make it worse. Thus, any meaningful legislation must contain strong provisions for open, nondiscriminatory transportation, both firm and interruptible. Therefore, PGC strongly supports the administration and would support S. 1302, introduced by the chairman of this subcommittee, if appropriate language and open-access transportation were added.

We do not think that legislation limited to the repeal of incremental pricing and the Fuel Use Act will have any meaningful impact on today's market problems.

The single most important issue to PGC is the need for legislation providing for open, nondiscriminatory transportation of natural gas.

Although order 436 is only 6 months old, open and nondiscriminatory transportation remains generally unavailable for several reasons. First, order 436 is voluntary. Pipelines need not open their systems to nondiscriminatory transportation unless they choose to do so.

Second, those pipelines that have considered opening their system pursuant to order 436 have often proposed conditions that undermine the basic content of that order.

Third, many parties continue to attach the validity of order 436 in any available forum.

Finally, pipelines may obtain transportation authorization through individual certificates without subjecting themselves to the nondiscrimination and contract demand reduction conditions of order 436.

In short, the interstate pipelines and many distribution companies continue to thwart the operation of the competitive forces by acting as bottlenecks to prevent or substantially limit meaningful gas price competition within their service areas. The only real solution to these problems is for the Congress to remove the barriers erected by the current pipeline practices and to provide for open access transportation.

Finally, PGC favors the repeal of incremental pricing in the Fuel Use Act, but notes that the bills limited to repeal of these provisions are not sufficient. The Fuel Use Act is having virtually no effect on industrial fuel selection because it contains a multitude of easily obtainable exemptions from the prohibition on boiler use of natural gas.

What is really impacting on industrial use of natural gas is the continuing refusal of the pipelines of the distribution companies to move low-priced natural gas owned by end users/shippers, for producers to end users. To merely repeal the Fuel Use Act and incremental pricing without dealing with those much more significant barriers to natural gas competition will do nothing to increase our ability to use gas in the current market.

In conclusion, PCS strongly supports enactment of legislation which recognizes and deals with the reality of the problems in today's gas markets. Thank you.

[The prepared statement of Mr. Merrels follows:]

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BEFORE THE
SUBCOMMITTEE ON ENERGY REGULATION & CONSERVATION
COMMITTEE ON ENERGY AND NATURAL RESOURCES
UNITED STATES SENATE

STATEMENT OF
THE PROCESS GAS CONSUMERS GROUP

April 15, 1986

SUBCOMMITTEE ON ENERGY REGULATION & CONSERVATION
COMMITTEE ON ENERGY AND NATURAL RESOURCES
UNITED STATES SENATE

STATEMENT OF
THE PROCESS GAS CONSUMERS GROUP
April 15, 1986

I am A. S. Merrels, Director, Energy Purchases and Hydrocarbon Ventures, Owens-Corning Fiberglas Corporation, and Chairman of the Process Gas Consumers Group.

The Process Gas Consumers Group (PGC) is an organization of eighteen large industrial consumers of natural gas organized to promote the development and adoption of coordinated, rational, and consistent federal and state policies with respect to gas use. Representing many of the nation's basic industries, our member companies own and operate hundreds of plants in virtually every state and purchase natural gas directly or indirectly from both interstate and intrastate pipelines, with most of our facilities on the interstate system. A list of our members is included as Attachment 1.

PGC appreciates this opportunity to offer its views on natural gas legislation pending before this Subcommittee.

I. PGC's Perspective

PGC members are energy intensive companies that individually spend as much as $200 million per year for their natural gas needs. Our members consume natural gas in manufacturing applications, including process, nonprocess, and boiler, and from our perspective, there are two paramount natural gas issues: (1) security of supply and (2) price.

Security of supply means to us the ability of consumers to depend upon their suppliers to satisfy their gas requirements. The current supply surpluses do not give us any significant comfort. because we remain skeptical that those resources will be efficiently produced, distributed, and replaced in a market that remains partially regulated under the Natural Gas Policy Act.

Natural gas prices, as with other inputs into the manufacturing process, present costs which must be recovered by companies in the prices charged for their products, We are willing to pay free market prices for gas, but we are strongly opposed to (1) paying prices higher than those which would be commanded in a truly free market and (2) paying a disproportionate share of gas costs so that other gas consumers can be subsidized, such as through so-called incremental or marginal cost-based pricing schemes. We believe that rates should be based on the cost of providing service. As consumers operating in competitive national and international markets, we and the Nation cannot tolerate the impact of artificially high gas prices on our businesses.

The gas market in recent years has been characterized by wildly disparate prices at the wellhead -- some far below "market clearing" and others substantially above it. Many pipelines have experienced industrial load losses caused by the purchase of expensive supplies under strict take-or-pay provisions which have, in effect, shut off cheaper supplies. High cost supplies were produced before lower-cost supplies, which further depressed demand and distorted the signals sent back to producers as to future gas needs, possibly setting the stage for potential future price premiums and shortages. Notwithstanding today's falling oil prices, pipelines continue to purchase expensive gas even though their own sales rates are higher than a free marketplace would permit. This situation is exacerbated by the significant barriers that remain to end user access to lower-priced supplies, barriers which also prevent producers from selling their lower-priced supplies into market and thus receiving much needed cash flow to encourage future drilling.

PGC's conclusion about what is needed to deal with these problems is that the interests of all involved in the natural gas industry -- producers, pipelines, distributors, end users, marketers, etc. -- will best be served by making the purchase, sale, and transportation of natural gas as market-oriented as possible. To accomplish this effectively, any legislative proposal must recognize and deal with the reality of today's gas market. Piecemeal tinkering with only one industry segment's perceived problems will merely continue or exacerbate the market distortions we have described. Thus, for example, any meaningful legislation must contain strong provisions for open access to nondiscriminatory transportation of both firm and interruptible gas supplies, because this will benefit end users, producers, pipelines and distributors by allowing market forces to eliminate bottlenecks in the system. In this spirit, PGC strongly supports legislation such as "Natural Gas Policy Act Amendments of 1986" recently proposed by the Administration. Similarly, we would support S. 1302, introduced by the Chairman of this Subcommittee, if appropriate language on open access transportation were added. We do not think that legislation such as S. 1125, which is limited to repeal of incremental pricing and the Fuel Use Act, will have any meaningful impact on market problems being faced today by all segments involved in the natural gas industry.

II. Specific Comments on Legislative Provisions

A. Open and Nondiscriminatory Access to Transportation

The single most important issue to PGC is the need for legislation providing for open, nondiscriminatory access to transportation of natural gas.

Order 436, issued on October 9, 1985 by the Federal Energy Regulatory Commission, represents the high-water mark for attempts to provide open, nondiscriminatory transportation in the natural gas industry. Yet, although Order 436 is nearly six months old, open and nondiscriminatory access to transportation remains generally unavailable. Indeed, the expiration of the previous blanket transportation certificate programs combined with pipeline reluctance to accept Order 436 has frequently diminished the availability of transportation for prospective shippers. Thus, while PGC strongly supports Order 436, we believe that Congressional action should be taken to bring about open, nondiscriminatory transportation in the natural gas industry.

There are several reasons why Order 436 has not resulted in the immediate, widespread availability of nondiscriminatory transportation. First, Order 436 is voluntary; pipelines need not open their systems to nondiscriminatory transportation unless they choose to do so. Second, those pipelines that have considered opening their systems pursuant to Order 436 have often proposed conditions that undermine the basic content of that order. Third, many parties continue to attack the validity of Order 436 in any available forum. Finally, pipelines may obtain transportation authorization through a Section 7(c) certificate of public convenience and necessity without subjecting themselves to the nondiscrimination and contract demand reduction and conversion conditions of Order 436.

The first and most obvious reason that pipelines have not implemented the open access provisions of Order 436 is that FERC believes that it lacks authority under existing law to compel contract carriage of gas. Thus, a pipeline can exercise its monopoly power by refusing to open its system and in fact, many pipelines have done exactly that. PGC is troubled by this refusal by pipelines to accept open access pursuant to Order 436, particularly given current conditions in the energy markets. Although oil and gas wellhead prices have fallen, many pipelines' rates have not. Thus, many pipelines and their distributor customers face a very real threat of fuel-switching by some of their customers, while captive customers -- including many industrial process and feedstock users -- are forced to pay above-market prices for utilities' gas. Faced with falling gas demand, which will decline further this summer, many gas producers face shut-in supplies even if they are willing to sell gas at market prices. Yet, most pipelines are unwilling to accept Order 436 and allow competitive forces to facilitate a market equilibrium. Instead, pipelines and distributors have tended to adopt a stop-gap approach of attempting to hold their current market share and profits through devices such as selective price cutting even as they file general rate increases.

A second problem is that pipelines that have considered implementing Order 436 have proposed conditions which would undercut, and in some cases negate, its basic intent. Several pipelines are currently attempting to "negotiate" so-called "settlement" agreements in pending rate cases which include provisions purporting to implement Order 436. However, armed with the threat of not accepting the Order, several pipelines have attempted to demand settlement agreements that often contradict the goals and express terms of Order 436. In some FERC proceedings, pipelines have agreed with their traditional wholesale customers -- including local distributors and fellow interstate pipelines -- to divide transportation rights in order to preserve their collective positions as monopolistic sellers through a variety of rate and service preferences which dramatically limit producers' and end users' ability to obtain fair, reliable transportation services. Thus, while the promulgation of the Order was an important first step, pipelines' monopoly power over transportation is frustrating achievement of truly open nondiscriminatory transportation. For example, while Order 436 mandates the allocation of capacity on a "first-come, first-served" basis, some pipelines and distributors have insisted on service preferences for their own sales and for distributor sales customers while producers and end users are left to accept the lowest quality interruptible service. To the extent that pipelines can insist on such conditions as the price for accepting Order 436, true open, nondiscriminatory transportation will never occur.

Even where pipeline capacity is available to a potential shipper, other settlement provisions have been proposed that will serve to discourage transportation by some classes of shippers. For example, penalty and balancing provisions have been proposed by some pipelines, which would require $5-$10 per Mcf penalties for minor delivery imbalances under circumstances that are totally unrealistic in the gas industry. If allowed to stand, these would have the effect of favoring their own sales or brokerage affiliates or of preventing transportation by all but the largest and most sophisticated shippers. While some pipelines have softened these provisions somewhat, the proposed penalties typically bear no relation to any costs imposed on the system and tend to deter many shippers.

While FERC should be able to ferret out the discriminatory proposals, it may take months to do so. And even then, pipelines may continue to withhold transportation until they get the terms they want.

Adding to the uncertainties is the third problem of the challenge to the legality of various aspects of Order 436 filed by numerous parties in the federal courts. For example, pipelines are arguing that, despite its voluntary nature, Order 436 is too close to mandatory carriage to be lawful under the Natural Gas Act or Natural Gas Policy Act. If Order 436, or some portion thereof, is overturned on appeal, nondiscriminatory transportation could again become an even more remote possibility.

Finally, the fourth problem with Order 436 is that pipelines have another transportation alternative. A number of pipelines have recently received individual Section 7(c) certificates of convenience and necessity authorizing them to transport gas for specified shippers. Pipelines can, in that manner, transport gas without subjecting themselves to the Order 436 conditions such as nondiscrimination and CD reduction. Although FERC has said that users or producers who are discriminated against can file complaints, that is rarely a realistic option for users or producers. Since the burden of proof is on the shipper while the pipeline possesses the data on which the complaint must be based, a complaint proceeding at FERC can take one to three years, which is totally unrealistic in a fast changing energy market.

Given these four problems, if it is to deal effectively with the gas issue, Congress must address the fact that interstate pipelines and many distribution companies have tended to act as obstacles to the operation of competitive forces that would smooth out price and supply distortions resulting from the NGPA. Because their facilities are essential to delivering gas to their customers, interstate pipelines and distribution companies have the power to act as bottlenecks to prevent or substantially limit meaningful gas price competition within their service areas. As the above-described problems illustrate, Order 436 is being thwarted by many pipelines, sometimes with the acquiescence of their distribution customers, and even over the objections of end users and producers. The only real solution to these problems is for the Congress to remove the barriers to entry erected by current pipeline practices and legislatively to provide for open access transportation.

B. Deregulation of Wellhead Price Controls

PGC continues to believe that deregulation of all natural gas at the wellhead, preferably by a time certain as called for in the Administration bill, is an important element of any natural gas legislation.

PGC is concerned that, while the conventional gas resource base may be sufficient to meet current levels of demand for some time, these resources will not be efficiently produced in the partially-regulated "market" under the NGPA. As previously noted, that market is characterized by disparate wellhead prices -- some far below competitive fuel costs and others substantially above them. Some pipelines are already experiencing real industrial load losses as they purchase expensive supplies under strict take-or-pay provisions and turn away cheaper supplies. High-cost supplies are being produced on some pipelines before lower-cost supplies, and retail gas prices for system supply have remained at relatively high levels over the past year, despite a substantial supply surplus and falling oil prices.

The NGPA created a part-regulated, part-deregulated market in which the "cushions" afforded to some pipelines by the regulated portion of the market have allowed outrageously high prices to be paid for gas in the deregulated portion of the market. The uneven distribution of those cushions among interstate pipelines led many to fear that, upon partial deregulation on January 1, 1985, deep-cushion pipelines would have a decided advantage over shallow-cushion pipelines in obtaining new gas supplies by bidding up the price of deregulated gas, rolling it in with their cheaper supplies, and yet still remaining competitive at the burner tip. The fact is that, during the three to four years immediately following enactment of the NGPA, pipelines effectively neutralized the potentially distorting effects of their own respective cushions by purchasing deregulated Section 107 gas at super-inflated prices. By the time that partial deregulation occurred on January 1, 1985, the combination of first, many pipelines' unintended neutralization of their gas cushions through purchases of high-cost gas, and second, rapidly falling market prices for new gas supplies, resulted in many pipelines' having weighted average gas costs *above* the current cost of new gas in the field. Rather than bidding prices *up* on January 1, 1985, pipelines invoked market-out clauses to try to bring prices *down* to market. Today, prices for new deregulated gas are, in some cases, *below* prices for some Section 104 "old" gas.

These anomalies can be best addressed by removing the price controls that have in many cases,in recent months become price "supports" for above market priced gas. These price controls were at the root of most of the natural gas industry's problems over the past two decades, such as the curtailments of the 1970s and they continue to create difficulties in today's market. PGC has long supported legislation to remove wellhead price controls on all gas, including "old" flowing gas, because of our firm view that a functioning competitive market is needed to balance supply and demand, without widely varying prices for a fungible commodity. Given the current low prices and the increase in sales that would be made possible by open access transportation, deregulation of currently regulated gas would not raise prices to consumers.

C. Repeal of Incremental Pricing and the Fuel Use Act

PGC also favors the repeal of incremental pricing and the Fuel Use Act but believes that such repeal should occur as part of a natural gas legislative proposal which also deals with today's real market problems, such as access to open, nondiscriminatory transportation.

The Fuel Use Act, contrary to the assertions of some, does not currently constitute a barrier to utilization of natural gas. As a major trade association of industrial users, many of whom are potentially affected by the FUA's prohibition on industrial use of gas or oil, PGC disagrees most strongly that repeal of FUA will do anything to assist our current inability to obtain gas for our plants. Apparently, many in Congress and elsewhere believe that a bill, such as S. 1125, only repealing the FUA and incremental pricing, would constitute a solution to the current problems of the natural gas market.

For example, an American Gas Association study of August 31, 1984, entitled "Projected Economic and Environmental Impacts of Retaining the Fuel Use Act Through the Year 2000," tries to make the case for legislation limited to FUA repeal by claiming that 1.9 quadrillion Btu's of gas would be available to industrial users annually if only FUA were repealed. On page 7, this study makes the rather extraordinary underlying assumption:

> ". . . it was assumed that the FUA exemption process is effectively inoperative. . . . it was assumed that the exemption process would not work as a result of either stringent regulatory enforcement policy, or the fear of plant operators of becoming involved in costly and time-consuming exemption procedures with the ultimate outcome unknown."

For the following reasons, this assumption is patently incorrect and makes the study worthless as any indicator of the real world of industrial gas use. The Fuel Use Act contains a multitude of exemptions from the prohibition on boiler use of natural gas, and under the Reagan Administration's 1981 revision of the Fuel Use Act rules, 46 Fed. Reg. 59872 (December 7, 1981), these exemptions are very easy to obtain. As shown in the attached materials from DOE annual reports on FUA, between January 1, 1983, and December 31, 1985, 86 exemptions were granted by DOE to utilities and Major Fuel Burning Installations (industrial plants) out of the 118 that were received and the remainder were being processed. No completed applications were turned down. The Fuel Use Act is having virtually no effect, contrary to assertions such as those of AGA, on industrial fuel selection.

What is really impacting on industrial use of natural gas is the continuing refusal of the pipelines and distribution companies to move low-priced natural gas owned by end user shippers from producers to end users, accompanied by the market distortions of wellhead price controls.

PGC does not disagree that the Fuel Use Act should be repealed because of the potential that it could be used by some future Administration to influence industrial fuel use choices as it did before the reforms of 1981. Similarly, incremental pricing can have the effect of distorting price signals, not only as to the current resource cost of gas, but even as to a pipeline's average cost of gas. This is because incremental pricing generally requires that non-exempt industrial boiler fuel users pay a gas price no less than the EIA-determined price of No. 6 oil; this requirement could in certain market circumstances deprive industrial users of the benefits of such producer-pipeline gas price renegotiation as does occur.

But merely to repeal the Fuel Use Act and incremental pricing as S. 1251 would, without dealing with more significant market barriers to natural gas access, will do nothing to increase our ability to use gas in the current market.

III. Conclusion

In conclusion, PGC strongly supports enactment of legislation which recognizes and deals with the reality of the problems of today's gas markets. Legislation, such as the Administration's bill accomplishes this particularly because of its provision for nondiscriminatory transportation of natural gas. Piecemeal approaches, which deal with limited or non-existent problems, will not provide the type of relief that is needed.

We appreciate the opportunity to appear before this Subcommittee on this most important topic and will be pleased to answer any questions you may have.

ATTACHMENT 1

PGC
PROCESS GAS CONSUMERS GROUP · SUITE 800/1666 K STREET, N.W.
WASHINGTON, D.C. 20006
202 887-3425

PROCESS GAS CONSUMERS GROUP
MEMBERSHIP LIST

Aluminum Company of America

American Can Company

Atlantic Richfield Company

Armco Inc.

Bethlehem Steel Corporation

Carpenter Technology Corporation

Chrysler Corporation

Cone Mills Corporation

Corning Glass Works

Diamond Shamrock Chemicals Company

Eaton Corporation

Ford Motor Company

General Motors Corporation

Hershey Foods Corporation

LTV Steel Company

National Can Corporation

Owens-Corning Fiberglas Corporation

Owens-Illinois, Inc.

ATTACHMENT 2

POWERPLANT
AND
INDUSTRIAL
FUEL USE ACT

ANNUAL REPORT

Submitted Pursuant to
P.L. 95-620, Section 806

March 1, 1985

U. S. DEPARTMENT OF ENERGY
Economic Regulatory Administration
Office of Fuels Programs
Washington, D. C. 20585

Sheet 1 of 2

EXHIBIT 1

STATUS OF EXEMPTION PETITIONS RECEIVED THROUGH DECEMBER 31, 1984 FOR NEW POWERPLANTS

Company	Facility Location	No. of Petitions Submitted	Disposition (at 12-31-84)	Federal Register Citation
U.S. Borax*	Boron, CA	1*	Granted Cogeneration	49 FR 7854 (3-2-84)
Calcogen, Inc.	Norwalk, CA	1	Granted Cogeneration	49 FR 21560 (5-22-84)
Bayou Cogeneration Plant	Pasadena, TX	1	Granted Cogeneration	49 FR 25513 (6-21-84)
Greenleaf Power Corporation	Sutter County, CA	1	Granted Cogeneration	49 FR 25513 (6-21-84)
Sacramento Municipal Utility District	Sacramento, CA	1	Granted Peakload	49 FR 31481 (8-7-84)
Anchorage Municipal Light & Power	Anchorage, AK	2	Granted Reliability of Service	49 FR 34397 (8-30-84)
Power Systems Engineering	Harris County, TX	1	Granted Cogeneration	49 FR 44945 (11-13-84)
Cogen Lynchburg, Inc.	LaPorte, TX	1	Granted Cogeneration	49 FR 47096 (11-30-84)
Turlock Irrigation District	Stanislaus County, CA	2	Granted Peakload	49 FR 49167 (12-18-84)
Northern California Power	Lodi, CA	1	Granted Peakload	49 FR 49707 (12-21-84)

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*Received during 1983.

Sheet 2 of 2

EXHIBIT 1 (Continued)

STATUS OF EXEMPTION PETITIONS RECEIVED THROUGH DECEMBER 31, 1984 FOR NEW POWERPLANTS

Company	Facility Location	No. of Petitions Submitted	Disposition (at 12-31-84)	Federal Register Citation
AES Geismar	Geismar, LA	1	In Process Cogeneration	---
AES Placerita	Newhall, CA	2	In Process Cogeneration	---
Alaska Electric Generation & Transmission	Soldotna, AK	1	In Process Reliability of Service	---
Calcogen, Inc.	San Luis Obispo, CA	1	In Process Cogeneration	---
Northern California Power	Alameda, CA	2	In Process Peakload	---
Northern California Power	Placer County, CA	2	In Process Peakload	---
Northern California Power	Ukiah, CA	2	In Process Peakload	---
Operating Leasing Services, Inc.	Chino, CA	1	In Process Cogeneration	---
Sunlaw Energy Corporation	Vernon, CA	1	In Process Cogeneration	---
Texasgulf, Inc.	Newgulf, TX	1	In Process Cogeneration	---
	Total Petitions (Including 1 submitted in 1983)	26		

EXHIBIT 2

Sheet 1 of 1

STATUS OF EXEMPTION PETITIONS
RECEIVED THROUGH DECEMBER 31, 1984
FOR NEW MFBIs

Company	Facility Loation	No. of Petitions Submitted	Disposition (at 12-31-84)	Federal Register Citation
University of Michigan	Ann Arbor, MI	2	Granted Cogeneration	49 FR 19698 (5-9-84)
Owens-Illinois	Orange, TX	1	Granted Emergency Purposes	49 FR 35222 (9-6-84)
General Motors Corporation	Shreveport, LA	1	In Process Lack of an alternate fuel supply at a cost which does not substantially exceed the cost of using imported petroleum	---
~~New~~ England Ethanol Products	Auburn, ME	1	In Process Emergency Purposes	---
Willamette Industries	Hawesville, KY	1	In Process Emergency Purposes	---
	Total Petitions	6		

ATTACHMENT 3

POWERPLANT
AND
INDUSTRIAL
FUEL USE ACT

ANNUAL REPORT

Submitted Pursuant to
P.L. 95-620, Section 806

March 1, 1986

U. S. DEPARTMENT OF ENERGY
Economic Regulatory Administration
Office of Fuels Programs
Washington, D. C. 20585

EXHIBIT 1

STATUS OF EXEMPTION PETITIONS
RECEIVED JANUARY 1 - DECEMBER 31, 1985
FOR NEW POWERPLANTS

Company/Location	No. of Petitions Submitted	Disposition & Citation
----COGENERATION----		
ARCO Petroleum, Watson, CA	1	In Process
American Cogen, Spreckels, CA	2	In Process
Basic American Foods, King City, CA	1	Granted, 51FR4788, 2/7/85
Carson Energy, Inc., Carson, CA	1	Granted, 50FR50196, 12/9/85
CoGen Kern Bluff, Inc., Kern, CA	1	In Process
Cogeneration & Tech. Dev., Atlas, CO	3	Granted, 50FR25754, 6/21/85
Crown Zellerbach Corp. St. Francisville, CA	1	In Process
Dartmouth College, Hanover, NH	1	In Process
General Electric, Lynn, MA	1	In Process
General Electric, Co., Texas City, TX	1	Granted, 50FR31904, 8/7/85
General Electric, Cogebay, TX	3	Granted, 51FR3400, 1/27/86
Gilroy Energy Co., Gilroy, CA	1	Granted, 50FR25119, 6/17/85
Harrisburg Energy Co., Harrisburg, PA	1	Did not need FUA exemption
Klondike Equity, Klondike V, CA	1	In Process
Klondike Equity, Klondike I, CA	1	Granted, 51FR4420, 2/4/86
Klondike Equity, Klondike II, CA	1	Granted, 51FR4419, 2/4/86
Klondike Equity, Klondike III, CA	1	In Process
Merck Co., Kelco, San Diego, CA	1	In Process
Northern Cogen One, Texas City, TX	1	In Process
OLS Berkley, San Francisco, CA	1	Granted, 50FR29738, 7/22/85
Simpson Paper Co., Pomona, CA	1	Granted, 50FR37401, 9/13/85
Smith Cogeneration, Firestone, OK	1	Granted, 51FR674, 1/7/86

EXHIBIT 1 (Continued)

STATUS OF EXEMPTION PETITIONS
RECEIVED JANUARY 1 THROUGH DECEMBER 31, 1985
FOR NEW POWERPLANTS

Company/Location	No. of Petitions Submitted	Disposition & Citation
----COGENERATION (Cont'd)----		
Sunlaw Energy Corp., Park I, CA	1	Granted, 50FR50197, 12/9/85
Sycamore Cogeneration, Sycamore, CA	4	In Process
Temple-Eastex, Diboll, TX	2	In Process
United Cogen Inc., Los Angeles, CA	1	Granted, 50FR33825, 8/21/85
Univ. of Alaska, Fairbanks, AK	1	In Process
University Cogeneration, Kern, CA	1	Granted, 51FR675, 1/7/86
Willamette Ind., Port Hueneme, CA	1	In Process
** Total Cogenerators	38	
----PEAKLOAD----		
Oklahoma Gas & Electric		
Horseshoe Lake, OK	4	Granted, 51FR4792, 2/7/86
Muskogee, OK	4	Granted, 51FR4791, 2/7/86
Mustang, OK	4	Granted, 51FR4794, 2/7/86
Seminole, OK	4	Granted, 51FR4793, 2/7/86
Sooner, OK	3	Granted, 51FR4952, 2/10/86
Santa Clara, City of, CA	1	Granted, 50FR41554, 10/11/85
Texas Utilities Generating		
DeCordova, TX	4	Granted, 50FR26033, 6/24/85
Permian Basin, TX	5	Granted, 50FR26035, 6/24/85
Morgan Creek, TX	6	Granted, 50FR26034, 6/24/85
Boston Edison, Walpole, MA	1	Granted, 51FR5758, 2/18/86
** Total Peakload	36	

EXHIBIT 1 (Continued)

STATUS OF EXEMPTION PETITIONS RECEIVED JANUARY 1 THROUGH DECEMBER 31, 1985 FOR NEW POWERPLANTS

Company/Location	No. of Petitions Submitted	Disposition & Citation
----SITE LIMITATION----		
Thermo Power & Electric	2	Granted, 51FR2543, 1/17/86
University of N. Colorado, CO		
** Total Site Limitation	2	
----COST----		
Consolidated Power, West Rutland, VT	1	In Process
** Total Cost	1	
----RELIABILITY OF SERVICE----		
Alaska Electric		
Hollywood, AK	2	In Process
Soldotna, AK	1	In Process
Anchorage Mun. Lgt. & Power		
George M. Sullivan #11, AK	1	In Process
George M. Sullivan #12, AK	1	In Process
Chugach Electric Assoc.		
Beluga #9, AK	1	In Process
Beluga #10/11, AK	1	In Process
Beluga #13/14, AK	1	In Process
Beluga #16, AK	1	In Process
International Station #4, AK	1	In Process
Soldotna #3, AK	1	In Process
Golden Valley Inc.		
Hollywood, G.V., AK	1	In Process
** Total Reliability	12	
TOTAL POWERPLANT EXEMPTION REQUESTS	89	

EXHIBIT 1A

STATUS OF EXEMPTION PETITIONS
RECEIVED DURING 1984, ACTIVE ON JANUARY 1, 1985
FOR NEW POWERPLANTS AND MFBI's

Company/Location	No. of Petitions Submitted	Disposition & Citation
----COGENERATION----		
AES Placerita, Inc. Newhall, CA	1	Granted, 50FR13273, 4/3/85
Applied Energy Services, Geismar, LA	1	Granted, 50FR16538, 4/26/85
OLS Energy, Chino, CA	1	Granted, 50FR47254, 11/15/85
Texasgulf, Inc., Newgulf, TX	1	Granted, 50FR8184, 2/28/85
** Total Cogenerators	4	
----PEAKLOAD----		
Northern California Power		
Alemeda Peaking Facility, CA	2	Granted, 50FR5296, 2/7/85
Placer County Peaking Facility	2	Granted, 50FR5297, 2/7/85
Ukiah, CA	2	Granted, 50FR14281, 4/11/85
** Total Peakload	6	
----RELIABILITY----		
Alaska Electric, Soldotna, AK	1	Granted, 50FR14413, 4/12/85
** Total Reliability	1	

INDUSTRIAL EXEMPTIONS

Company/Location	No. of Petitions Submitted	Disposition & Citation
----EMERGENCY PURPOSES----		
New England Ethanol, Portland, ME	1	Granted, 50FR6379, 2/15/85
Willamette Industries, Hawesville, KY	1	Granted, 49FR10095, 3/13/85
** Total Emergency	2	
----COST----		
General Motors, Shreveport, LA	1	Granted, 50FR13411, 4/4/85
** Total Cost	1	

EXHIBIT 2
STATUS OF EXEMPTION PETITIONS
RECEIVED JANUARY 1 THROUGH DECEMBER 31, 1985
FOR NEW MFBI's

Company/Location	No. of Petitions Submitted	Disposition & Citation
----COST----		
Huntsville, City of, AL	4	In Process
LTV Steel Co., Aliquippa, PA	1	Granted, 51FR3824, 1/30/86
Owens-Illinois, Orange, TX	1	In Process
Ponderay Newsprint, Usk, WA	1	In Process
** Total Cost	7	
----EMERGENCY PURPOSES----		
Boise Cascade, DeRidder, CA	2	Granted, 51FR4789, 2/7/86
** Total Emergency	2	
----MIXTURES----		
Occidental Chemical, Lake Charles, LA	2	In Process
Power Developers, Inc. Alta, AR	1	In Process
** Total Mixtures	3	
----SITE LIMITATION----		
General Electric, Fitchburg, MA	1	Granted, 51FR3647, 1/29/86
Penwalt Corp., Wyandotte, MI	2	In Process
** Total Site	3	
TOTAL MFBI EXEMPTION PETITION RECEIVED	15	

Senator NICKLES. Thank you, very much. We appreciate your comments.

Our next panelist is Gordon Gooch, senior partner of Baker & Botts, from Washington, DC, and also counsel for Petrochemical Energy Group.

STATEMENT OF GORDON GOOCH, COUNSEL, PETROCHEMICAL ENERGY GROUP

Mr. GOOCH. Looking at the situation today, confronting us on the natural gas, according to the latest EIA composite, we get a very interesting picture. You see that the section 104 gas sells for an approximate average of $1.35 and 105, $1.98; 106, $1.12; the new gas, an average of $3.18; the section 107, $3.94; pipeline-to-pipeline imports at $3.41, with an average of $2.67, and you see the percent of total volume.

Senator NICKLES. Are those wellhead prices?

Mr. GOOCH. These are above the other purchases. The wellhead purchases, according to EIA, come out to 45, nationwide composite.

Notice, please, the percentage of total volume and then notice, further, what is not on this chart, because I didn't want to cram too much on there—as you were pointing out to the Secretary, Mr. Chairman, in each of these categories of wellhead price controls, what maximum wellhead price controls remain?

There are wellhead price controls in each of these categories; some with price in the $6 range. Furthermore, over half the gas shown on this chart cannot be sold to another purchaser, even when there is no contract. It is either held forever to the original purchaser, until you get the permission of the FERC, or until you get the permission of the original purchaser.

So there are four sets of problems. There is the problem of restricted access, there is the problem generated by the low-cost gas, there is a problem generated by high-cost gas, and there is take-or-pay.

Now, take-or-pay, of course, no one worries about take-or-pay on 50-cent gas. You worry about take-or-pay when you get to the other end of the spectrum. When you get to the other end of the spectrum, you notice something very interesting. The largest category of gas that has both regulated and deregulated, almost the same size as the section 104, is the section 102 gas. And what do you see?

You see that, on average, the regulated gas—the forever regulated gas sells for a higher price than the deregulated gas.

Now, what can cause this type of behavior? The answer, of course, is Federal price controls. The removal of Federal price controls would do what? It would put on the table all of those elements—access, the lower price contracts, the higher priced contracts and take-or-pay.

If you don't do that, you are going for a regulated solution, and I would like to disagree with Mr. Lawrence. He calls for the abrogation of indefinite price clauses. The abrogation.

Well, if you did that, according to the EIA's latest study, 60 percent of the gas in the 104 category would fall in price on deregulation. Why? Because the Federal Government for years regulated the contract terms that you could put in the contract, and forbade—forbade—any contract provision that allows you to adjust your price, other than fixed and tied to maximum lawful prices. The Government generated that, not the parties.

We, in the industrial community say, prices may go up—may go up on deregulation. We will take that risk because we think in the long term, the competition, with all those issues on the table, coupled with carriage, would make all of our friends in the industry—producer, pipeline, and distributor—behave rationally.

And I want to say one other thing; take-or-pay is not a problem just between producer and pipeline. There are pipelines fighting each other over take-or-pay, where one pipeline wants take-or-pay for one, and the other doesn't want to pay. There are take-or-pay issues between pipelines and distributors, where they are fighting like in Transco and Texas Eastern over take-or-pay.

So we say, give us an industry that has to renegotiate everything; don't just pick one segment and help that out.

[The prepared statement of Mr. Gooch follows:]

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TESTIMONY
ON BEHALF OF THE
PETROCHEMICAL ENERGY GROUP

Committee on Energy and Natural Resources
Subcommittee on Energy Regulation and Conservation
United States Senate

April 15, 1986

Washington, D.C.

TESTIMONY OF THE
PETROCHEMICAL ENERGY GROUP
April 15, 1986

My name is Gordon Gooch. I am counsel to the Petrochemical Energy Group ("PEG"). PEG is an association of companies that rely on oil and natural gas as raw materials as well as for fuel use. PEG sincerely appreciates the opportunity to be heard.

PEG SUPPORTS THE TERMINATION OF PRICE AND OTHER CONTROLS AFFECTING WELLHEAD SALES OF GAS AND SUPPORTS FERC JURISDICTION OVER NON-DISCRIMINATORY TRANSPORTATION

The Petrochemical Energy Group respectfully urges the favorable consideration of legislation to remove the federal price and allocation controls over the wellhead sales of natural gas as part of a comprehensive reform of federal regulation that would (1) repeal the authority to constrain demand for gas and oil (2) repeal the authority to use discriminatory pricing as a tool to limit wellhead prices as well as a tool to direct gas costs to specific consumers and (3) grant to the Federal Energy Regulatory Commission the authority to do directly what it is attempting to do indirectly: require non-discriminatory transportation.

The cornerstone of any reform of the natural gas situation is the removal of federal price and allocation controls. The cushion of the lower cost, forever-regulated gas supplies is the root cause of the problems in the gas industry, whether in times of shortage or of surplus. Until the cushion problem is resolved, the Congress will be plagued with requests for special relief of one kind or another, as piecemeal adjustments are sought.

CURRENT SITUATION

According to the latest information available from the Energy Information Administration, based on projections gleaned from all PGA filings by the interstate pipelines, the composite situation appears to be:

	Average Price	Percent of Total Vol
"Old" NGPA Section 104 gas	$ 1.35	29%
Intrastate section 105 gas	1.98	1%
Rollover Contracts section 106	1.12	3%
New Gas (102, 103, 108, 109)	3.18	38%
High Cost Section 107	3.94	6%
Other Purchases than Wellhead	3.41	22%
Total Purchases	$ 2.67	

One who examines that information might well ask: how can it be that natural gas, a fungible commodity, has such a wide range of average prices? The answer comes back because of one major factor: federal price and allocation controls on wellhead sales.

Rather than confront the issue as a whole, there are some who prefer to isolate components in order to obtain an improvement over this status quo from their perspective, and this has yielded a gridlock.

GRIDLOCK ON THE SUBSIDIARY ISSUES OF WELLHEAD CONTROLS

The three major segments of the gas industry--the producer, the pipeline, and the distributor-appear to have achieved a gridlock. There appear to be four major issues, leaving aside, for the moment, the issue of contract carriage:

(1) federal restrictions on the sale of gas to a new purchaser when the wellhead contracts expire or are terminated, commonly called the ABANDONMENT and RIGHT OF FIRST REFUSAL problem;

(2) FEDERAL PRICE CONTROLS that can operate to restrain or operate as a price support for gas prices at the wellhead;

(3) contracts that call for the payment of the maximum lawful price established by the Congress or by the Commission under the NGPA or for a payment based on the agreement of the parties, commonly called by some the "NON-MARKET RESPONSIVE" contracts;

(4) whether the producer, the pipeline, or the distributor should pay the cost of holding gas supplies shut in the ground, commonly called the TAKE-OR-PAY problem.

Even when segregated and isolated in this manner, it is apparent that the issue is the same: price and access to supply. These are driven by the federal controls.

Abandonment jurisdiction means that the FERC must give its permission before deliveries of gas can be terminated, even under an expired contract. Thus, some forever-regulated gas supply cannot be sold to another purchaser without the prior consent of the FERC, only recently and sparingly given. This means that access to some 46% of total volume is severely constrained. On top of this, additional volumes cannot be sold to another purchaser without the first call being given to the former purchaser, a lesser restriction but a restriction nonetheless.

With federal price controls permanently in place, some gas is held well below the price that other purchasers would be quite willing to pay in order to secure a supply of gas. The parties cannot even agree to adjust the price to a higher market level; the federal government prohibits that without prior FERC approval.

When the so-called "non-market responsive" contracts are considered, it is necessary to place them in two subsets. Those that have been deregulated (and one party seeks relief from the contract in one form or another) and those sales that have not been deregulated where the ceiling prices established by the federal government are operating to maintain prices at levels where one party wishes relief.

It must be recognized that both subsets are no accident but are the result of the design of the NGPA. While some price ceilings were frozen at the level set in the 1970s by the Commission and adjusted only for inflation, subject to the continuing jurisdiction of the Commission to raise the price ceilings, incentive categories were also established by the Congress--but in two subsets.

One subset included those categories of gas that were designated for deregulation. The opportunity of parties to live by their contracts was deemed to be an incentive.

The other subset includes those categories of gas that were designated to receive a regulated incentive price.

Therefore, to attack those two subsets in isolation is to attack the design of the NGPA.

The result of this intentional design of the NGPA can perhaps be best observed by examining the EIA current data on Section 102 gas. That is the largest category of gas that is comprised of both deregulated and forever regulated incentive gas, comprising some 24% of EIA's projected total supply, almost the same volume as the old NGPA section 104 gas in relative volume. EIA informs us that, of the three sub-categories of section 102 gas, the following is the average price:

102 OCS New	$ 2.84	Deregulated
102 Onshore	3.15	Deregulated
102 OCS Old	3.77	Forever-Regulated

That is a thirty-four percent differential from the lowest average to the highest average price of the same category, with the average regulated priced above the average deregulated prices.

Next, as to take-or-pay, this too is related to price. Would anyone be concerned about take-or-pay payments on the sixty cent (60¢) section 104 gas?

PEG RESPECTFULLY SUGGESTS THAT TERMINATION OF THE FEDERAL CONTROLS WOULD LEAD TO A RATIONALIZATION OF THE SITUATION FAR BETTER THAN ANY OTHER ALTERNATIVE

This solution would be painful for some. The status quo is painful for some. The other suggested solution: reimposition of some form of federal controls on contracts would be painful on some.

But by allowing renegotiation with all four of the issues on the table offers the best hope of all the options. This requires termination of price and allocation controls.

What happens if federal regulation of the sale of gas at the wellhead is removed?

(1) The contracts between the parties will control according to the agreed upon terms.

(2) Where there are no contracts, gas may be sold to any potential purchaser without prior approval of the FERC or the prior purchaser.

Some will object to both results. Some will say that parties should not be permitted to live under private contracts. Some will even argue for the abrogation of contracts by the federal government. They will argue that the price of gas at the wellhead will increase substantially over the status quo case.

Others will argue that, with all contracts on the table and open to renegotiation, there will be an accommodation sufficient to improve the status quo situation. These, we believe, will not claim that all contracts will be renegotiated nor that there is a perfect correlation between those who have old gas and those who have the new and high cost gas, either by company or on an individual pipeline system, and this we understand.

What will the average price be upon decontrol? It could go up, it could remain the same, it could go down.

Some industrial users, such as PEG, are willing to assume the risk that wellhead prices will go up. We accept this risk, as consumers, because we believe that, in the long run, competition, both from gas and from other sources of energy, will induce a rational behavior by all segments of the gas industry--the producer, the pipeline, and the distributor.

And we believe that this rational behavior will be better induced by allowing the market to operate rather than by relying on federal regulation.

And how long would that process of rationalization take?

The answer to that lies in whether or not the Congress gives to the FERC the power to require that the available capacity on interstate pipelines be opened to all shippers and end users on a non-discriminatory basis. If the Congress does this, the process will be much shorter.

To an industrial user, open access means that the end user will have a legally enforceable option of dealing with (a) a local distribution company or (b) a pipeline or (c) a producer or any combination thereof. The user is perfectly willing to pay the fair cost of the use of transportation facilities owned by others.

If the end user is discriminated against in either cost or quality of service or on availability of service or if the end user is forced to be a captive customer, then the rationalization process will take much longer.

GAS SUPPLY

In times of apparent surplus, it is perhaps more difficult to express concern about supply. But supply is a real concern. We remember curtailments. We believe that the attempt by the federal government to administer prices and to allocate supply was the principal cause of curtailments.

If the Congress opts to reimpose controls, in whole or in part, then again the FERC has to decide what the "right" price or series of prices is in order to maintain an adequate supply for the present and the future. We would suggest, again, that a regression toward more controls will lead us back into curtailments. We would prefer to rely on the collective judgment of hundreds of producers, pipelines, distributors, and end users.

CONCLUSION

PEG thus respectfully commends to the Committee those bills now pending that achieve the goals of a comprehensive deregulation of natural gas at the wellhead and at the burner tip and that grant to the FERC the jurisdiction to compel that unused capacity be made available for transportation on a non-discriminatory basis.

Senator NICKLES. Mr. Gooch, thank your for you comments. And all the panelists. We appreciate your statements. I think it is obvious you don't all quite agree. I don't think I am going to be able to get everybody, Senator Ford, to agree on this panel today, but it is my hope that we will be able to make some progress and hopefully point the various industry sectors together.

One of the reasons why we haven't had natural gas legislation in the past is that we have had very divided opinions from everybody in the sector and it has made it very difficult for us to be able to pull in a consensus piece of legislation.

It is my hope, in working with Senator Ford, and other members of this committee, Senator Domenici and Senator McClure, maybe we can pull together and come up with more of a consensus and be able to get us some legislation.

Just a couple of quick points. I heard most everyone on the panel—and correct me if I am wrong—I think I heard everyone on the panel state that they felt like we should eliminate end use restraints, such as Fuel Use Act, and incremental pricing. Some disagreement on the impact of it. I think I heard several people say it would make very little or marginal impact because exemptions would be granted anyway.

I heard some people say it might make a significant impact. Was there pretty much a consensus on the panel that we should, as either part or individually, repeal the end use restraints on natural gas?

Mr. NELSON. I did not say individually.

Senator NICKLES. So, you, Mr. Nelson, are saying you do not think that any legislation should be moved that only deal with end use restraints? You felt, if I remember, that the No. 1 important thing was access; is that correct?

Mr. NELSON. Senator, I came in here fairly loose on that subject, but it is now—I have heard a lot of talk about hanging a coal capital subsidy onto the Fuel Use Act deal, so I think I have to go back and look this situation over.

Is the question just a pure Fuel Use Act, incremental pricing repeal, or is it——

Senator NICKLES. Well, let's delve into that just a little bit, and Senator Ford, will, I am sure, want to touch on it, as well. The coal-capable, and we will have Mr. Bagge representing the coal industry in a moment, and you will hear the term "coal-capable," but Mr. Harlow, and anyone else who is in the process of building a plant and making it coal-capable—I am not sure it has been defined, but the essence of it is, if you design a plant, that you are going to have to have the boiler capable of burning coal.

Do you think that is an adequate requirement? In other words, you would have to have the facility designed to burn either gas or coal, is my understanding. I don't know if Senator Ford might have a better definition.

Mr. HARLOW. I have not participated in any projects yet where we have actually done that kind of evaluation. It would certainly change the economics if you had to put in all the equipment and everything to burn coal and bas both; that would make a—well, for instance, coal plant currently, priced on maybe 10 years from now, would be $1,200 a kilowatt. A gas unit combined cycle unit, like I was mentioning before, it is about $600 a kilowatt. So, it would depend on how much equipment you put it in, and I don't have it in pieces so that I can really comment on how much the boiler would cost and how much the coal pile and the crushing facilities and the train access and so forth—So, I am really not prepared to testify.

I would be happy to try to respond in writing or something in the future, if you would like to see that. But I think the point is that it would certainly impact the economics of the project if it had to be both completely coal capable, able to handle it right today.

It also would make tremendous fuel problems in trying to assure some kind of long-term supply for it, too. So there would be some difficulties. I haven't really examined them all.

Senator **Nickles**. Mr. Merrels, do you want to chime in on that?

Mr. **Merrels**. The only comment that I wanted to go back to, that we favored both the repeal of incremental pricing and the provisions of the Fuel Use Act, but in looking at today's problem, our top priority is the one of open access, nondiscriminatory transportation, to get the gas moving from the wellhead to the customer.

Senator **Nickles**. Mr. Lawrence.

Mr. **Lawrence**. Mr. Chairman, although I heard different priorities, I, too, thought I heard a consensus that we needed to get rid of these market restraints. We know of an instance recently in Louisiana, where there is a baseload plant that is dual fuel capable and they are switching from about 75 percent gas/25 percent coal, to at least 50-50 and this because coal is more economic.

So, I think where the coal capability, the designers of the installation take that very much into account and they utilize it.

I would point out just one more thing, on the exemptions. At the present rate that exemptions are being filed, we are bottlenecking a demand of 225 billion cubic feet a year. That is the average rate. At the way they are coming in in the last few months, it is 350 billion cubic feet a year. At the weighted average price of gas, that is over $750 million a year that is being deprived.

Senator **Nickles**. On the exemptions, what is the time lag if a utility or industrial company is going to file for an exemption in the Fuel Use Act; how long does it take before DOE would approve it?

Mr. **Lawrence**. There have been some 325 exemptions since 1978, and our analysis of that is that the average delay is 5 months from the time it is filed. Estimates range from 3 to 6 months in the preparation of those filings. So we are talking about a delay of as much as a year.

Now when this amount of exemptions begins to proliferate, as it is, and we do help our how-to book is going to help, because we believe in working all sides of the street. If exemption is the only way to get at it, let's help people get the exemptions. But that delay is going to be at least a year; it is going to cost at least $100,000, but, again, I think as Mr. Harlow has pointed out, and I would emphasize, it is the projects that might not ever come to the exemption stage that really are the iceberg and not the tip.

Senator **Nickles**. Mr. Harlow, Senator Ford indicated an interest, and I understand where he is coming from as far as protecting his base. You mentioned in your company, OG&E, you are burning a lot more coal. I know in the last couple of plants that you built were built for coal—last how many?

Mr. HARLOW. Last five.

Senator NICKLES. And so you haven't purchased any—were you purchasing those before the Fuel Use Act? Were you going to coal anyway?

Mr. HARLOW. We were going to coal anyway, but of course, the Fuel Use Act was a further reason because there wasn't any choice after that was passed.

Senator NICKLES. Of those five plants, are those still—I am just wondering on the economy, and you mentioned cost for Btu and so on. For those larger plants, are they more economical to stay in coal? I mean, I don't really see you changing those from coal to gas, or is that a possibility?

Mr. HARLOW. Well, currently in the State, gas a $1.30 or $1.40, in the spot market, is cheaper than our coal price of $1.60. We are backing out some coal and burning some of our gas plants longer, producing more gas. We are going to back out about 10 million dollars' worth of coal this year and burn more gas because it is more economic. So we do switch back and forth, and by loading the plants, we can operate the gas plants longer or the coal plants longer, depending on which ones have the most economic fuel.

Now, after you have paid the first cost of the capital, then all you are doing is buying fuel, so we buy the cheapest fuel.

Senator NICKLES. What is the price of coal today?

Mr. HARLOW. At the plant, coal is about $1.61 per million Btu's, and our gas price average is about $2.79 or $2.80, along in there, but, again, spot prices of gas are lower than that.

Senator NICKLES. I am going to ask a couple of questions on carriage, but I think Senator Ford wants to ask some about the Fuel Use Act before that.

Senator FORD. Mr. Chairman, what Mr. Harlow was actually saying, if he was gas-capable he couldn't burn coal. He wouldn't have the ability to switch. If it is coal-capable, then you can burn gas, but if it is gas-capable only, then you wouldn't have the ability to switch to coal at $1.61 when your gas prices are at $3 to $4; is that not correct, Mr. Harlow?

Mr. HARLOW. That is true to some degree. However, in our coal units, we don't even have adequate gas facilities in there.

Senator FORD. But if it is a gas facility, you would not be in the posture of burning coal. But if it was coal, you would be in the posture of converting to gas.

Mr. HARLOW. You could conceivably convert the unit to gas, but we haven't done it—we don't have that capability now.

Senator FORD. Well, one, you can go to gas, and the other one, you cannot go back to coal. That is the point. He would not have the option of going to lower cost fuel—even burning coal, Mr. Chairman, based on price, where natural gas has been higher.

That is the point I would like to make here. The long-term problem, as I asked the chairman of the Illinois Commerce Commission, about the depreciation, and the price that you are asking for gas will fluctuate much faster than coal. So you would have to have the ability to write it off at a longer period of time—I think—based on that, or you would have to switch to a lower priced fuel in order to compensate for long-term investment.

Mr. **Harlow**. Senator, we do depreciate our gas and coal plants on the same life currently. We have some gas plants that are 40 years or more older, and we are going to extend the life on those, and we do use about 30 years on our coal currently.

Senator **Ford**. Well, anyhow, I think, Mr. Chairman, we are beginning to the get to the point where even though Oklahoma is a gas State, and he said, not too long ago—10 years—you were 98- or 100-percent gas. And now in the circumstances, they have shifted to coal; that his last plants are coal-capable. They could be converted to gas, better than the other way around.

I think we are beginning to get on a track here. As far as the Fuel Use Act, we can talk about getting rid of that, if you want to, subject to a little problem I have.

Senator **Nickles**. I appreciate your comments. Let me just follow up on that, Mr. Harlow. Would you respond, or supply information of the cost that is required—you talked about building some additional facilities. I don't know if they are baseload facilities or smaller facilities, and I am thinking that you were planning on those being gas. What would the additional cost be or burden be, just to leave it open to where it could be made to burn coal, but I am not assuming that we are talking about making it to where it would be available to burn coal tomorrow, but at least that it would be designed in such a way that it could burn coal in the future.

Mr. **Harlow**. I can't respond, but I would be willing to respond to you later in writing. I think the point would be that it would depend on how much you were going to do. If we build the boiler size so that it could be coal-capable, that would be one selection, and site it, and take care of the pollution problems, and all this. That would be one selection.

If you put all the equipment in, of course, as you say, we are back up to the other situation. So, I think it would be a matter of the definition and we do have some older plants in Oklahoma, incidentally, Senator, that are designed with boiler size so that they could be converted to coal—they never were. They were sized that way and they are gas their total lifetime, but it has been done before—that part.

Senator **Ford**. Part of the concern here, Mr. Chairman, is long-term source that Mr. Harlow spoke about. That is an underlying consideration. We know the long-term source of coal—I have sat here in this room now for 10 years, and we have been up and down like a yo-yo—we are not going to have any, we are short, we have to get the incentive to go out and drill, and then we begin to find a way, and we fight like the devil to give you an incentive on new gas, and we do a lot of other things. Now we have more gas than we know what to do with.

It is a little bit frustrating. I think that we even had during the testimony on this panel, Mr. Nelson indicated that maybe he wanted to go back and cogitate a little bit, if I can use the Kentucky term, on what his position is. It is getting interesting.

Senator **Nickles**. Be careful. Mr. Nelson is getting ready to oppose your idea.

Senator Ford. No, Mr. Nelson is a nice fellow and I am, too. We are not going to have any problems. [General laughter.]

Senator Nickles. One of the other provisions that has been discussed by this panel that I heard everyone—except for Mr. Lawrence of AGA, and Mr. McGrath of INGA—and that is the carriage provision. The carriage provision that was called for by DOE's proposal.

I think I heard everyone say that that was a good proposal. I think I also heard everyone say, with the exception of the pipeline representatives, that that was more important than anything else in the bill. Is that an understatement?

Mr. Gooch. I think the wellhead price control issue is more important; carriage is right up there with it.

Senator Nickles. Mr. Nelson.

Mr. Nelson. Senator, I hate to give priority. As you know, we believe in a comprehensive deal, but I would certainly say impact on the Nation, gas decontrol is most important.

Senator Nickles. Gas decontrol?

Mr. Nelson. Carriage very closely behind, and Fuel Use Act, of interest.

Senator Nickles. Mr. Lawrence and Mr. McGrath, you have heard a lot of statements today in support of—I think I heard both of you make mention—and I guess maybe I will move over to decontrol on the pricing before I would get into access. I will swing into that, first.

Both of you, I think I heard mention that you are willing to move or have some renegotiation on the old price, or forever regulated prices. I heard Mr. McGrath say you wanted that, but in exchange for some take-or-pay concessions on the top side. Is that an accurate——

Mr. McGrath. We indicated, Mr. Chairman, our support of your bill, S. 1302, on decontrolling on expiring contracts and renegotiated old contracts, provided it would be coupled with addressing the problem contracts, take or pay, or high cost.

Senator Nickles. Now, when you say addressing the the take-or-pay or high-cost contracts, are you talking about abrogating all those contracts that are at a certain level? Where do you define——

Mr. McGrath. We had coupled, as you know, access to transportation with addressing the contracts by way of creating an incentive for the pipelines and the producers to sit down at the bargaining table and renegotiate those contracts which were causing the take-or-pay obligations to accumulate and to become so burdensome and to negotiate those contracts with very high floors and then that are not being negotiated downward.

We call that conditional access to transportation. If a producer wanted to have access to transport gas on the pipeline, before having access, he had to sit down and do some renegotiating on the problem contracts that he had with the pipeline. The producers did not indicate agreement with that, and as I indicated in my prepared statement, and also alluded to in my oral statement, we tried mighty hard at the bargaining table. We had numerous sessions with both distributors and producers in trying to work out a solution to this and when the DOE bill came along, the producers wrote us and suggested that they cancel a meeting that we had scheduled with them wherein we were to have received the proposal from them as to how to address the problem contracts. That meeting was canceled.

Senator **Nickles**. Let me ask, INGA's position was, well, you agree with the contract carriage provision, or some type of a transportation provision in exchange for a reduction in what you would term contract problems, take-or-pay problems.

Mr. **McGrath**. Yes. Essentially that. We agree also, as I have indicated in my testimony that the problem is also with the low-cost gas, which in the descriptive term "nonmarket responsive," I suppose you could say 50-cent gas is nonmarket responsive. $4, $3, and $3.60 and so on is not market responsive.

We are saying that those kind of contracts need to be renegotiated, and we are hoping that could be done, but they don't seem to be interested in doing that.

Senator **Nickles**. Mr. Lawrence——

Mr. **McGrath**. I might say under order 436, the reason that the pipelines have been reluctant to embrace order 436, open transportation, is because it has completely stripped the pipelines of any leverage they had to negotiate and, as Senator Bradley described it last fall at your hearings in November, that the pipelines are ripsawed between the distributors at the one end where they can cut down their contract demand and takes from the pipeline and there is no relief at the other end of the pipeline in their purchases from the producers.

Senator **Nickles**. Mr. Lawrence.

Mr. **Lawrence**. Mr. Chairman, we have long felt that your approach, in S. 1302, to old gas decontrol was the best way to get at it. The expiring contracts or the renegotiation, and probably the renegotiation is the important part of that. But, again, for the first time, we are ready to come before this Senate and say—we will support that so long as we let those continued regulated high-price NGPA gas savings in the contracts pursuant to them come down.

We made the same analysis that you saw in Mr. Gooch's chart. Indeed, the negotiations downward of the 102(c) gas that had been deregulated, they were negotiated, by our calculations, from $3.78 to about $3.13, when we made the analysis. The continued 102(d), for example, were renegotiated downward from $3.78 to about $3.72.

As a result of knowing that deregulation was going to come on 185, you began to see the market-out or economic-out provision come into contracts in the post-1978 period. They began to appear in 1979, more so in 1980, pretty prevalent in 1981, and 1982 and thereafter, they were the order of the day.

But I don't think you have so many of those market-outs in that where the Federal ceilings, which have now become floors, were thought to keep control on the price of gas. Now, we have hoped that, indeed, if you just take the controls off, that that renegotiation would come downward. But then on further analysis by the pipeline companies, we see that old bugaboo that faces the gas industry, indefinite escalator clause, the favored nation; the situation with the dingbat contract—it is a producer term, not mine—has a way of cascading throughout all of the contracts so that the price of everything goes to highest.

Now, our proposal to eliminate that, is that a firm of contract abrogation? Of course, it is. But I submit to you, Senator, it is the most benign, market-oriented, free, competitive-type abrogation I can envision. But get rid of those escalators.

Senator NICKLES. I might just make a comment. I would be interested if you can supply the committee with escalators that have been escalating prices in the last year or so, because, again, in my producing State, we haven't had price escalator clauses triggering the increases that I am aware of.

If you could let us know of that, I would be interested in seeing it because prices have been falling, and prices have been falling substantially.

Prices have been falling substantially in all deregulated categories; the regulated categories continue to escalate and that is one of the dichotomies I think that we need to address.

Mr. Gooch.

Mr. GOOCH. May I say, sir, that barring mathematical error, that none of these averages or the subsets in there of the high-cost categories are at the maximum lawful price, with the exception of the forever regulated 103 gas—is at the maximum lawful price. Every other category, on average, appears to be substantially below the maximum lawful price, even when it is regulated.

Senator NICKLES. Including your offshore?

Mr. GOOCH. Yes, sir, because in the offshore, the maximum lawful price is now in the $4.12 or something range.

Senator NICKLES. And you are saying those contracts are not for that amount?

Mr. GOOCH. According to EIA, the average is below the maximum lawful price, so I don't know that it is fair to say that it is operating as a floor. I do think it is fair to say that it appears that in some instances the regulated price is higher than the free market price that is caused by the indefinite price clauses that Mr. Lawrence is now challenging.

Senator NICKLES. We still have a significant percentage of those contracts that are tied to the highest allowable price, dating back to way back when?

Mr. NELSON. Pardon me, Senator; I missed it.

Senator NICKLES. Do we still have—and I am thinking of your,what, 102(d)'s and whatever contracts that say we will charge the highest allowable price under NGPA?

Mr. NELSON. Yes.

Senator NICKLES. And that would be in the case where Mr. Lawrence is talking about that ceiling became a floor?

Mr. GOOCH. I am just saying that apparently the facts don't support that contention.

Senator NICKLES. I am saying probably a significant percentage of the contracts would have that provision and then there is probably a lot that is market-sensitive and have been readjusted or renegotiated. Mr. Nelson.

Mr. NELSON. Senator, at the appropriate time I would kind of like to tell you how this really works. You know, I have forgiven over $1.5 billion worth of take-or-pay in the last 2 years, and we now have an outstanding balance of about $100 million. Now.

I have one contract alone where the company is committed to take 38 BCF of gas a year and the operative price in the contract is $12.70. It doesn't take you long to run that out and see that is over $500 million from that company. That company has a book value right at $500 million. If you pull out their debentures, you are left with $200 million. I can bankrupt them now.

Is it in my interest to bankrupt them? It is just like a hydrogen bomb; if I pull the trigger, I am lucky if I end up with 10 percent of the $200 million. I am about 10 percent of their supply, so I get $20 million from that. My gas is on the spot market and I am getting around to trying to find a pipeline that will transport it, pay them their margin—do that kind of business—all of a sudden, I am looking for someone to buy that at distressed prices. It is completely in my interest to work with the pipeline company.

Now, we see the gas prices falling at the wellhead, and I presume we will very shortly begin to see margins falling—pipeline distributors' margins. But so far, at least the facts that are available, show that producers are ignoring the contracts, negotiating with these companies and coming down.

So the fact is, we have killer contracts out there and we would be dumber than anything you know of if we tried to envoke them.

Senator NICKLES. I am going to ask one final question. I heard Mr. Lawrence and Mr. McGrath say that there is still take-or-pay out there—is it $6.1 billion? You mentioned a smaller figure. What was your figure?

Mr. NELSON. Mine was Shell.

Senator NICKLES. No, but I think in your statement, you mentioned——

Mr. NELSON. I think we had a notional number for NGSA—the members that we canvassed had a total of $8.3 billion from 1981 to 1985. Now, these are notional numbers, you know. Many of them—I haven't made a take-or-pay claim as a take-or-pay claim for 3 or 4 years.

Senator NICKLES. OK. One final, quick question. I need to get to our next panel, in deference to them. The statement was made that if the pipelines were to grant access and did not get some reduction in take-or-pay, that was what they were bargaining access for. Mr. McGrath even mentioned that maybe our legislation should mandate—correct me if I am wrong, Mr. McGrath—but the legislation be drafted in a way that said, yes, you have access if you make a reduction in take-or-pay.

We are negotiating—in other words, we will give you access if you will give us the corresponding reduction in take-or-pay. Would that be accurate?

Mr. McGRATH. Basically, I am saying if you give us leverage to sit down and negotiate reductions or changes in the take-or-pay—there may be other reasons why in a given instance it would be perfectly lawful and suitable for a company to maintain whatever take-or-pay agreement it had with the pipeline.

We are not saying not to reduce the take-or-pay automatically, or mandate that. We are saying that in order to have access to the transportation, the statute should say that the producer and the pipeline—the producer should agree to—have to agree to sit down and negotiate his contracts with that pipeline.

Senator NICKLES. OK.

Mr. LAWRENCE. Senator, could I say a word on access, if you are going to get back to that? Because I was one of the ones that is opposed to it.

Senator NICKLES. I heard you.

Mr. LAWRENCE. I think you hit it. The two page proposal that Secretary Herrington laid out, as much mischief as that would cause, it has a way of becoming a 60-page proposal in the Senate, and probably that much more in the House. We are going to have a very complex, bureaucratic arrangement running a very complex transportation system. We are scared to death of it.

What we have in order 436 is far less than perfect. We have been fussing about it. Everybody on this panel has been fussing with the Commission about it, but they are working their way through it. They are making some improvements and when mistakes are made, at the Federal Energy Regulatory Commission on this, there is a great deal more flexibility to work it out than when it gets put in a rigid Federal statute. And that is what we are concerned about.

Senator NICKLES. Mr. Gooch.

Mr. GOOCH. May I just speak to that? I would like, with all due respect to Mr. Lawrence, to disagree with that totally. The Federal Energy Regulatory Commission, by its own admission, lacks jurisdiction. It has made 436 because it believes it must—voluntary.

The Secretary and the President's bill gives to the FERC the jurisdiction that it now lacks to make unused capacity available, and we, the users, are going to be hardpressed to keep with our brothers in the pipeline and distributor industry who have people employed day in and day out over there when—but we are willing to take our chances that the FERC will be fair. We ask you that you give them jurisdiction so that unused capacity can be made available on a nondiscriminatory basis.

What we are seeing instead is that it is not going to be nondiscriminatory transportation because the users are not—somehow not going to be able to get on the system when it is under a voluntary system.

Senator NICKLES. Let me just follow up with a question. Some would come back and say, well, if you give strictly access—nondiscriminatory access on capacity available basis, and have no countervailing reduction in liability, a producer will come in, take that industrial customer—yourself, or whoever it might be in the Northeast—leave that pipeline still sitting with the liability to another producer with no sales to pay off, and so you might have increased take-or-pay liability.

What would be your response to that?

Mr. GOOCH. I am very pleased to have a chance to answer that, because I believe that those problems will be resolved if the producers and the pipelines and the distributors and the users, but particularly the parties to the contract, can negotiate on all issues—where they don't have to go to the Federal Government for abandonment; where they are not limited to the lower prices, as they are now; where you can't get a permanent abandonment at the present time from the FERC.

You can't agree to raise the prices in your $1.35 contracts. You can't do that. All the focus is to go to one end of the bargain, and say, give up your take-or-pay, give up your high-priced contracts; we are keeping the abandonment, we are keeping you under the low-priced contracts forever.

Well, you can understand why people don't bargain in that atmosphere. Let all those issues be on the table. And, as Mr. Nelson says, it is in his best interests to rationalize that system and we, the users, will be the beneficiary. We can do this much. We can make it very unpleasant, if we possibly can, on someone that tries to maintain us as a captive and tries to force us to take gas only from them. In that sense, we will perform the very useful function in getting the major factors of the industry to renegotiate the problem, which is the Federal controls over the wellhead sales.

Senator NICKLES. I need to move on to the next panel. The administration's bill handles it as far as the prices are concerned. Does it also handle it as far as the dedicated gas?

Mr. GOOCH. Yes, sir.

Senator NICKLES. To our panelists, I appreciate your comments, very much.

Our next and final panel will please come up.

To all of our panelists, I appreciate your patience and indulgence. Mr. Seibert, if you would please proceed.

STATEMENT OF H. RICHARD SEIBERT, VICE PRESIDENT, RESOURCES AND TECHNOLOGY, NATIONAL ASSOCIATION OF MANUFACTURERS

Mr. SEIBERT. NAM has been a strong proponent of natural gas deregulation because we believe it is vital to our Nation's industrial competitiveness, to our economy and to our national security.

The natural gas market, unfortunately, has been plagued by confusion and inefficiency resulting from a long and complicated 40-year history of Federal Government regulation.

In fact, it is the only energy commodity that is price controlled by the Federal Government. Industrial consumers are convinced that the price and supply of natural gas will suffer further distortion unless major changes are made.

With all the intent of Congress to create a fair and equitable natural gas system, the Natural Gas Policy Act of 1978 is simply not working. On January 1, 1985, wellhead prices were removed from about 50 percent of domestic natural gas supplies. Partial decontrol has not led to price flyups, as many predicted, but has instead decreased natural gas prices, increased competition and introduced greater market flexibility.

This alone should be evidence that the marketplace, and not the Federal Government, is the best allocator of energy supplies. One only needs to look at the results of oil deregulation in 1981 to see how the natural gas consumers and the U.S. economy will experience large economic benefits by full deregulation.

Until total deregulation takes place, the marketplace will be hampered and distorted with supply and demand signals caused by remaining price controls on old gas, and restrictive regulatory system imposed on the natural gas industry.

NAM strongly supports comprehensive reform of natural gas policy and supports total decontrol of the wellhead of all natural gas in orderly market, establishment of nondiscriminatory, mandatory contract carriage for natural gas based upon presumed pipeline capacity, consisting of the reasonably foreseeable needs of present customers; ensure that all buyers have equal access to all natural gas supplies and repeal of incremental pricing and remove the mandatory demand restraints under the Power Plant and Industrial Fuel Act, which limits flexibility.

Mr. Chairman, NAM supports each bill being considered by the committee today; S. 1302, S. 2205, S. 1251, and S. 2285, as they are in line with our policy. However, we want to make it clear that NAM supports a comprehensive approach to natural gas.

Thank you, Mr. Chairman, for the opportunity testify.

[The prepared statement of Mr. Seibert follows:]

TESTIMONY OF
THE NATIONAL ASSOCIATION OF MANUFACTURERS
BY
H. Richard Seibert
Vice President
Resources & Technology
NAM
BEFORE THE
SENATE ENERGY AND NATURAL RESOURCES COMMITTEE
SUBCOMMITTEE ON ENERGY REGULATION AND CONSERVATION
NATURAL GAS LEGISLATION
APRIL 15, 1986

Mr. Chairman, Members of the Committee, I am H. Richard Seibert, Vice President of Resources & Technology for the National Association of Manufacturers (NAM). I am accompanied today by Jana Oakley, NAM Director of Energy.

We commend the Committee for holding these hearings and thank the Chairman and his staff for giving NAM this opportunity to express its views on various natural gas bills pending before the Congress.

NAM is a voluntary business association of over 13,500 companies, large and small, located in every state. Our members range in size from the very large to over 9,000 small manufacturing firms that each have less than 500 employees. NAM member companies employ 85% of all workers in manufacturing and produce over 80% of the nation's manufactured goods. NAM is affiliated with an additional 158,000 businesses through its Associations Council and the National Industrial Council.

Mr. Chairman, decontrol of natural gas prices is not a new issue to anyone in this room. We continuously come back to Congress for help because we feel it's vital to our nation's industrial competitiveness, to our economy, and to our national security.

Natural gas is a major source of energy in the American economy. Since 1960, it has provided about one-third of all domestically produced energy. Industry consumes about 40 percent of all natural gas used in the United States. Natural gas is easily transported, has clean environmental properties, and can be used in process, feedstock and boiler applications. Because of its premium qualities, its price and supply are of vital importance to industrial consumers. NAM is therefore, most interested in legislative and regulatory proposals affecting natural gas.

The natural gas market, unfortunately, has been plagued by confusion and inefficiency resulting from a complicated 40 year history of federal government regulation. In fact, it is the only energy commodity that is price controlled by the federal government. These regulations have engendered a rigid and inflexible market unresponsive to the forces of supply and demand. Existing law prevents producers, pipelines and distributors from adjusting to changing market conditions. Industrial consumers are convinced that the price and supply of natural gas will suffer further distortion unless major changes are made.

Congress passed the Natural Gas Policy Act (NGPA) in 1978. NGPA was intended to restore order to the natural gas market, yet many of its provisions contributed to increased uncertainty. The Act brought all natural gas production under federal regulation, removed general Federal Energy Regulatory Commission power over gas pricing and instituted a schedule of prices for the future. NGPA provided that the price of "new" gas (gas developed after 1977) would be allowed to rise at a rate slightly faster than inflation and would be deregulated in 1985. The price of "old" gas (gas developed in 1977 or earlier) would receive nonuniform regulatory treatment.

The intent of the law was to enable the controlled price of gas to reach its free-market price by 1985 through the partial decontrol initiative. To prevent price controls from leading to shortages, various regulatory barriers to gas consumption were instituted, such as the Fuel Use Act and incremental pricing. With all the intent of Congress to create a fair and equitable natural gas system, the NGPA is simply not working.

There is no better time than now to decontrol all natural gas prices. On January 1, 1985, wellhead price controls were removed from about 50 percent of domestic natural gas supplies. Partial decontrol has not led to price "fly-ups" as many predicted, but has instead decreased natural gas prices, increased competition and introduced greater market flexibility. This alone should be evidence that the marketplace and not the federal government is the best allocator of energy supplies. The NAM strongly believes that if the natural gas market were not regulated, but allowed to operate freely like all other energy markets, natural gas prices would decline.

Widespread support for comprehensive deregulation should be put forth by all segments of industry. One only needs to look at the results for oil deregulation in 1981 to see how the natural gas consumers and the U.S. economy will experience large economic benefits by full deregulation. Until total deregulation takes place, the marketplace will be hampered with distorted supply and demand signals caused by remaining price controls on old gas and the restrictive regulatory system imposed on the natural gas industry.

We believe it is obvious that artificial, below market price ceilings have negative supply reprecussions. That, along with the inherent discrepancies between the interstate and intrastate markets, have resulted in:

1. A threat to national security;

2. A possible interference with reindustrialization and employment improvement;

3. A disincentive by some segments of society to conserve this precious fuel; and

4. Unfair competitive advantages and disadvantages amongst American industries.

By restraining domestic natural gas exploration and production, lack of decontrol has impeded the nation's ability to further reduce oil imports, thereby threatening the national security. As a result of deregulation of oil prices, conservation and other measures, the United States has made progress towards achieving the critical national goal of reducing dependence on costly, unstable sources of foreign oil. But there is still a long way to go to reach energy independence.

The nation is still dependent on foreign oil for over 30 percent of its petroleum needs. This dependence costs our domestic economy money, jobs and national security. Unless there are adequate economic incentives to produce domestic natural gas supplies, our susceptibility to oil imports will continue.

In addition, unless American industry has confidence that additional supplies of natural gas will be forthcoming, there could very well be increased hesitancy to proceed with contemplated expansions. Thus, an increased supply of natural gas would leave more money in this country and encourage industrial expansions. We believe that combination is important if reindustrialization is to be successful.

Deregulating natural gas will make more gas available now and in the future at realistic, market-related prices, and will help the nation's energy supply picture overall. Realistic gas pricing will encourage gas producers to drill for more gas.

Also vital to the natural gas market is the ability to foster competition by allowing open access to all producers and consumers. This would enhance competition by allowing all consumers access to the most inexpensive gas supplies. The Federal Energy Regulatory Commission has attempted to create a more competitive market by ordering a new rule intended to encourage pipelines to sign contracts to carry from producers' wells to gas users, such as industries and local gas utilities. This rule, however, has met many stumbling blocks over the past couple of months which have created such a chaotic atmosphere that the new order is not working effectively. This ruling and its aftermath only emphasize the need for legislation addressing open access for transportation of all gas.

The National Association of Manufacturers believes that current natural gas policy and the related regulatory structure benefits neither producers, users, nor the nation at large. The NGPA has clearly failed to meet the legislative intent of the Congress and its overall deficiencies are more apparent now than ever. The Fuel Use Act and the incremental pricing provisions of NGPA have introduced widespread inefficiencies and market disorders. NAM believes that the free-market, rather than the federal government, is the most efficient allocator of energy resources. As you know, NAM actively fought for total decontrol of the natural gas market in past Congresses.

In January 1985, the NAM's Board of Directors, consisting of this nation's leading industrialists and representing virtually every segment of American industry, overwhelmingly approved a policy reemphasizing the total deregulation of all natural gas.

NAM strongly advocates comprehensive reform of natural gas policy and supports the following principles:

- Price decontrol. Total decontrol of the wellhead price of all natural gas in an orderly manner;
- Contract Carriage. Establishment of nondiscriminatory mandatory contract carriage for natural gas based upon presumed pipeline capacity consisting of the reasonably foreseeable needs of present customers;
- Equal Access. Insure that all buyers have equal access to all

supplies of natural gas;

- Demand Constraint. Repeal of incremental pricing and removal of mandatory demand constraints under the Powerplant and Industrial Fuel Use Act which limit flexibility;
- Excise tax. NAM opposes an excise "windfall profits" tax on natural gas which would reduce the positive effects of decontrol;
- Public lands. Make federal lands available for development in an orderly and reasonable manner.

Decontrol of all gas, old and new, would help eliminate the market disorders in the natural gas industry. Allowing the price of all gas to reach its true market level will encourage conservation by all users and spur additional exploration and production of natural gas supplies.

Mr. Chairman, NAM supports each bill being considered by the Committee today (S. 1302, S. 2205, S. 1251, and the Department of Energy's proposal) as they are in line with our above stated policy. However, we want to make very clear that NAM supports a comprehensive approach to natural gas policy with each of our Board approved principles outlined above.

The NAM believes that total natural gas deregulation is good energy policy and that it must be accomplished now.

Senator NICKLES. Thank you, very much.
Mr. Knapp.

STATEMENT OF DAVID L. KNAPP, MANAGER, PLANNING COORDINATION, EXPLORATION AND PRODUCING DIVISION, MOBILE OIL CORP.

Mr. KNAPP. Thank you, Mr. Chairman. Mobile believes that a significant segment of the Nation's gas resources is in jeopardy under the current price regulatory system. The market signals are distorted, creating inefficient allocation of gas usage and costs and Mobile believes that the free market forces provide the best, most rational approach to long-term resolution of future potential supply problems.

We strongly support comprehensive legislation, including total removal of wellhead price controls, and provisions for flexible and nondiscriminatory access to pipeline transportation.

Repeal of legislative market constraints, such as those contained in the Fuel Use Act, and the incremental pricing provisions of the Natural Gas Policy Act would be appropriate policy when price signals are allowed to reflect market conditions more accurately.

The continued regulation of old gas at below market prices would prevent the development and production of large quantities of gas in old fields. These are reserves that would be prematurely abandoned, and yet they are less expensive to develop and produce than new gas.

The subsidy for high-cost gas will lead to more rapid depletion of lower cost reserves, leaving only the higher cost gas at higher prices for consumers.

Over the past 20 years, the reserve base in the lower 48 States has declined 42 percent, to 163 trillion cubic feet; a 9½ year's supply at the current, reduced annual rate of production, compared with over 18 years of supply in 1964.

The recent drastic decline in oil and gas prices has dropped U.S. exploration and development activity to very low levels. Working over and developing reserves in old gas fields is perhaps the single largest source of new supply for domestic markets. The renewed activity in these old fields could be critical to the survival of drilling contractors, and service and supply companies essentially to the infrastructure of the U.S. exploration and producing business.

Mobile supports S. 2285 because it decontrols all gas by a date certain; does not abrogate contracts; provides the Federal Energy Regulatory Commission with the necessary authority to require nondiscriminatory transportation service at just and reasonable rates when that capacity is available, and it repeals the legislation constraining the markets for gas.

While S. 1302 moves in the right direction and is a clear improvement over the present situation, it is premised on the basis that prices should remain controlled until a contract expires. In the case of life-of-lease contracts, large reserves of gas would never been decontrolled.

Deferring decontrol for the life of the contract, or forever in the case of life-of-lease contracts, would mean operating at a loss, relinquishing the lease or losing production to premature abandonment.

Removing Federal controls from the remaining gas categories by a date certain does not interfere with the terms of existing contracts and does not differ in any respect from the removal of controls in January 1985.

Contrary to the predictions by advocates of Federal control, no adverse consequences occurred when crude oil and part of our gas supply was decontrolled. The free market proved to be the most efficient mechanism for allocating resources necessary to maintain supply at the lowest possible prices. Thank you.

[The prepared statement of Mr. Knapp follows:]

TESTIMONY OF MOBIL OIL CORPORATION

TO THE

COMMITTEE ON ENERGY AND NATURAL RESOURCES

SUBCOMMITTEE ON ENERGY REGULATION AND CONSERVATION

WASHINGTON, D.C.

APRIL 15, 1986

Good morning Mr. Chairman and members of the Subcommittee. My name is David L. Knapp, and I am Manager, Planning Coordination, Exploration and Producing Division, Mobil Oil Corporation. Mobil appreciates this opportunity to present its views on the natural gas legislation under consideration today.

A significant segment of the nation's gas resources is in jeopardy under the current price regulatory system. Market signals are distorted creating inefficient allocation of gas usage and cost. Mobil believes free market forces provide the best, most rational approach to long term resolution of future potential supply problems. Mobil strongly supports comprehensive legislation, including total removal of wellhead price controls and provisions for flexible and non-discriminatory access to pipeline transportation. Repeal of legislated market constraints such as those contained in the Fuel Use Act and the incremental pricing provisions of the Natural Gas Policy Act would be appropriate policy when price signals are allowed to reflect market conditions more accurately.

A fundamental cause of the existing and potential gas market problems is the continued regulation of old gas at prices below market levels. This barrier has prevented development of substantial old gas reserves due to unattractive economics at the low regulated prices. In some instances, loss of reserves is occurring because of premature abandonment. As a result, higher priced gas is being consumed, thus weakening U.S. energy security through increased dependence on imported oil and gas.

Mobil agrees with the Department of Energy's position that the system of vintaging prices is disruptive to the efficient operation of gas markets.

Due to the artificial price signals produced by vintaging, producers have explored for and produced higher cost new gas reserves. At the same time, some old gas reserves are being prematurely abandoned even though those reserves are less expensive to develop and produce than other gas sources. The existing pricing structure for old gas will lead to a significant loss of lower cost domestic reserves and eventually higher prices for gas consumers.

Some opponents of decontrol maintain a free market is inappropriate given the present surplus of gas supplies. This argument does not acknowledge the declining reserve base or the history of the gas market. Despite the deliverability surplus of recent years, U.S. gas reserves continue to decline. Over the 20 year period from 1964 to 1984, U.S. lower 48 proved reserves fell from about 280 trillion cubic feet to 163 trillion cubic feet, or 42 percent. Over the same period, our reserve/production ratio has fallen from 18.3 to 9.5. To ignore this trend would subject the industry to the wide swings in gas supplies we have experienced for the past two decades. The abundant supplies of the early 1960's were consumed at prices below replacement cost, followed by shortages and rapidly rising prices of later years. It is reasonable to project gas supplies will eventually tighten and prices will rise. By taking action today, we can mitigate this trend through increasing the availability of domestic supplies from older fields. These reserves cost less to produce and transport to market than new supplies from frontier areas.

The current period of declining energy prices has caused a sharp drop in U.S. exploratory activity for both crude oil and natural gas. New projects are simply not economic even with reduced drilling costs.

Working over and developing additional producibility in old fields is perhaps the single largest source of new supplies for domestic markets. Regulated prices below market values do not provide economic returns sufficient for companies to invest new money in old fields. Drilling contractors, service and supply companies, critical to the infrastructure of the U.S. exploration and producing business, face a very uncertain future as exploration and drilling activity is drastically curtailed. New projects in old fields would alleviate some of the problems confronting the service industry. Maintaining the industry's infrastructure is essential to future energy development.

Recent studies have been made by the Department of Energy and Shell Oil Company in connection with the Federal Energy Regulatory Commission's rulemaking to consider raising old gas prices. These studies show that up to 42.5 Tcf of old gas supplies would be added as a result of higher prices. We agree with these estimates. An example of the detrimental effect of low prices for old gas can be illustrated by a specific Mobil example. Mobil produces gas from the Piceance Creek Field in Colorado which is subject to regulated old flowing prices, currently at 54¢ per Mcf. At this price level, the life of this field is estimated at 14 years, with an estimated recovery of 18.2 Bcf. If, for purposes of illustration, it is assumed that upon decontrol this gas can be sold at say $1.54 per Mcf, the life of the field would be extended to 28 years and ultimate recovery would increase to 30.1 Bcf. In other words, the $1.00 price increase would double the economic life of this field and increase ultimate recovery by 65 percent. Prices higher than $1.54 would, of course, increase the ultimate recovery even more. This additional supply would help to reverse the declining reserves trend and reduce the need for future reliance on imports.

Opponents of decontrol argue it would result in higher overall prices for gas consumers. The forces at work in today's gas market, a market characterized by excess deliverability and intense price competition at the wellhead, effectively refutes this argument. Over the past two years, encompassing partial decontrol as of January 1, 1985, the average gas purchase costs by the 30 major interstate pipelines have fallen about $0.33 per MCF, from $2.84 per MCF in February, 1984 to $2.51 per MCF in February, 1986. Even more significantly, we estimate prices for new production entering the market, primarily represented by spot supplies, have declined from about $3.15 per MCF to $1.50 per MCF. Moreover, the pressure of the recent dramatic decline in competing fuel oil prices is likely to result in even lower average wellhead gas prices in the near term. If old gas prices are permitted to rise to market levels resulting in the supply response from old fields, the presence of competing supplies now available to consumers would prevent any increase in average delivered gas prices. In fact, higher contract prices would be forced down to market clearing levels.

Under the current vintaging system, the pipelines' old gas cushion continues to be a dominant factor in the relative size of the pipelines' average cost of gas. A study of January 1986 gas cost data by Foster Associates shows old gas purchases as a percent of total field purchases vary widely among major interstate pipelines, from a low of 14 percent for Florida Gas to a high of 66 percent for Northwest Central. Likewise, average old gas prices exhibit considerable variation, ranging from $0.72 per MMBTU for Texas Eastern to $1.19 per MMBTU for Trunkline. The inequities caused by differing proportions of old gas dominate the competition among pipelines. Those pipelines with larger cushions of old gas enjoy a competitive advantage over other pipelines. Additionally, customers of pipelines with large old gas cushions benefit unjustifiably over customers of pipelines without large old gas cushions. Decontrolling old gas and putting downward pressure on higher priced contracts will tend to eliminate regional differences, not only benefitting consumers but also the producing regions dependent on income from old gas fields.

The industry's experience with partial decontrol of higher priced gas as of January 1, 1985 under the Natural Gas Policy Act provides the basis for our belief the industry is capable of resolving contract issues between producers and pipeline customers. So-called inflexible contract clauses have been and are continuing to be renegotiated. Prices declined and no fly-up occurred as predicted by many observers. Take-or-pay obligations continue to be resolved in settlement negotiations. For example Mobil settled almost one half billion dollars of take-or-pay claims through 1985. About $200 million in claims are currently being negotiated. Market conditions dictate the terms of on-going contractual relationships. Federal regulation more often than not interferes with amicable resolution of our business problems.

Mobil supports S.2285 because it decontrols all gas by a date certain, does not abrogate contracts, provides the Federal Energy Regulatory Commission with the necessary authority to require non-discriminatory transportation service at just and reasonable rates and repeals legislative provisions constraining markets for gas. Alternatively, while S.1302 moves in the right direction and is a clear improvement over the existing situation, it is premised on the basis that prices should remain controlled until a contract expires. Deferring decontrol for the term of a contract would, in many cases, mean requiring a producer to operate at a loss or to relinquish the lease because it no longer produces in paying quantities. Gas produced under life of lease contracts, in particular, would never decontrol and production would be forever lost to premature abandonment.

Legislation which lifts federal price controls from all gas by a date certain will not interfere with the terms of any existing contracts. In the majority of contracts, including the life-of-lease contracts I have already mentioned, the producers and the pipelines have agreed to pricing provisions to be applied in the event of deregulation. This approach to price decontrol would be the same as that under the NGPA in January 1985. At that time certain categories of gas decontrolled whether or not the gas was currently under contract. The parties were able to either apply contract provisions providing for prices in the event of decontrol or renegotiate contracts if there were no provisions for decontrol. There is every reason to believe the same process would occur today with a bill providing for decontrol of all remaining gas categories at a specific point in time.

We do not believe the provision in S.1302 allowing for decontrol of gas if the parties renegotiate the contract to expressly provide for decontrol is an acceptable substitute. There would be, at this time, no incentive for a pipeline to renegotiate since the gas will remain subject to the pipeline at the lower price if there is no renegotiation. If the parties had already previously agreed under their contracts on what would happen in the event legislation deregulated the gas, such agreement should be allowed to stand. There is no reason to endure the adverse supply consequences caused by regulation of gas prices solely on the basis of when a contract might expire. For these reasons, Mobil supports S.2285. It allows gas to be deregulated if a contract was entered into after the date of enactment or if the parties agree to deregulation. In any event, all gas would deregulate on April 1, 1987. S. 2285 would end the economic inefficiencies and regional inequities caused by artificially low prices.

Mobil supports S.1251 and S.2205 as additions to an acceptable decontrol bill. Such provisions, as part of S.2285, will permit natural gas to compete with other fuels, free from needless government interference. However, we do not believe that implementation of those bills alone without a decontrol provision will solve the longer-term problems of the gas industry and the nation. Therefore, Mobil does not recommend repeal of the Fuel Use Act and incremental pricing provisions of the NGPA as stand-alone legislation.

In addition, Mobil urges that legislation requiring open access carriage by natural gas pipelines be included in any natural gas package proposed. Mobil supports those provisions of S.2285 which give the Commission authority to direct an interstate pipeline to transport on behalf of third party shippers if the pipeline has capacity. Legislation allowing producers to compete by providing access to transportation would have the salutory effect of more efficient, i.e. lower cost, transportation to the market place.

Thank you for your attention. I would be pleased to answer any questions you may have.

Senator NICKLES. Mr. Knapp, thank you, very much, for your comments.

Mr. Legato.

STATEMENT OF CARMEN D. LEGATO, NATIONAL ASSOCIATION OF STATE UTILITY CONSUMER ADVOCATES

Mr. LEGATO. Thank you, Mr. Chairman. I am here on behalf of the National Association of State Utility Consumer Advocates, the American Peoples' Counsel, a membership organization of the State officials in 34 States, who under State law are responsible for representing the interests of residential and, in some cases, commercial consumers of natural gas.

Some of the bills here have in common, Mr. Chairman, the repeal of certain restrictions on the use of gas under the Fuel Use Act, and repeal of title 2 of the NGPA, incremental pricing.

Although as a group, NASUCA would not oppose these changes as part of forward-looking comprehensive reforms. Our position is that, one, legislative energies directed to natural gas should not be dissipated on ineffectual piecemeal changes, and two, that those bills attack largely secondary problems or nonexistent problems.

If you talk to people who have actually attempted to increase gas use in powerplants in the Northeast, for example, to back out imported oil, you will find that the real problem is not the Fuel Use Act or incremental pricing, exemptions from which are readily available.

The problem is the unwillingness of pipelines to transport the gas.

The administration's recent proposal is the only bill before you that addresses the central problem facing producers and consumers today; the perceived lack of authority for the FERC to order the pipelines transport gas. Our position is that no legislation dealing with gas should be considered without addressing that central issue.

Don't be misled by a few pipeline companies arguing that carriage legislation is not possible. In the last Congress, the full committee approved a carriage bill 18 to 1, if you recall.

Attached to my written testimony, which I ask you to accept for the record, is a joint statement that was prepared by representatives of producers, industrial consumers, residential consumers and state commissioners who, at that time, were supporting open carriage legislation.

Carriage legislation has the support of a broad bipartisan group in the House, as well, including Congressmen Dingell and Broyhill. There is simply no justification for ignoring that issue, which, until corrected, more than any other perceived shortcoming of existing law, will, in the words of the FERC, result in enormous loss to producers, consumers and the economy in terms of jobs and net economic efficiency.

Producers and consumers have a common stake in nondiscriminatory access to transportation. Legislation that is not directed to accomplishing that injures both by foreclosing the opportunity to attack the core problem facing the industry.

The administration bill, though a step in the right direction on carriage, has several critical flaws that I have outlined in my written statement, that we feel must be addressed. We are committed to ironing out differences and are confident that there is a way to do.

Briefly, we have to principle objections to the administration bill, and also, one of these applies to your bill, as well, Mr. Chairman; the failure to provide equal access to firm transportation for local distribution companies purchasing for residential and commercial markets. This group of the marketplace must have access at the same time as large manufacturing plants have access to deal directly with producers, to buy natural gas.

Second, the failure to link deregulation of old gas to the renegotiation of contracts for new gas that would establish it at above market levels in reliance on the price controls for old gas. If these fundamental flaws are corrected, we will work toward a compromise in comprehensive gas legislation.

Mr. Chairman, I appreciate your position concerning contract abrogation premised on sanctity of contract. But the principle behind that, Mr. Chairman, is to preserve expectations of parties. That is the legal theory, the premise upon which contracts are enforced.

But, I believe that your bill fails to reflect the reality that the contracts for new gas were premised upon expectations of continued price controls on old gas, and continued abandonment authority of the FERC, notwithstanding termination of contracts would prevent it from being sold elsewhere, and especially would prevent it from being sold below its artifically restrained price.

Now, the prices for new gas has been recognized by DOE and everyone, were set artifically high in this contracting process between 1978 and 1982, because of the expectation of continued controls on old gas. You can't destroy the expectation by lifting old gas price decontrols and allowing that price to rise without allowing for the market to renegotiate the above-market price contracts under these inflexible indefinite escalators.

We advocate not a governmental solution to that, but simply providing the basis for parties to renegotiate without contractual liability in the event they can't agree on new price terms. Don't set a take-or-pay limit; simply give to the parties the opportunity to renegotiate without contractual liability, and to find another seller or buyer, if they can't agree. Thank you.

[The prepared statement of Mr. Legato follows:]

Testimony of
Carmen D. Legato, Esquire
on Behalf of
The National Association of State Utility Consumer Advocates and The Maryland People's Counsel

Introduction and Summary

My name is Carmen D. Legato. I am a member of the firm Swidler & Berlin, Chartered, in Washington, D.C. I am appearing on behalf of the National Association of State Utility Consumer Advocates (NASUCA) and the Maryland People's Counsel, a member of NASUCA. NASUCA is a membership organization of officials in 34 states that under state law are required to represent the interests of residential consumers and, in some cases, commercial consumers of natural gas and other utilty services.

This hearing concerns, in part, a draft of proposed legislation submitted by the Administration entitled the "Natural Gas Transportation and Regulatory Reform Act of 1986." The other bills are similar in their overall effect to the Administration's proposal, though different in their particulars. The Administration's proposal has four principal parts: provisions concerning non-discriminatory transportation by interstate gas pipeline companies, provisions deregulating prices and eliminating non-price controls for "old" gas that was not deregulated by virtue of the Natural Gas Policy Act of 1978, a section eliminating restrictions on the use of gas contained in the Fuel Use Act of 1978 and a section repealing the incremental pricing provision of Title II of the NGPA. My testimony today focuses upon the first and second of these provisions, transportation and wellhead deregulation.

The remarks accompanying the Administration's bill make two important claims concerning the effect of these provisions. First, they characterize the bill as one substituting free-market forces for regulation, and second, they argue that the effect of this bill will be to more efficiently allocate resources and to reduce prices to consumers of natural gas. Support for these conclusions is premised on the success of deregulatory policies, in particular those concerning oil prices, and partial deregulation of natural gas in 1985 accomplished by the Natural Gas Policy Act of 1978 (NGPA).

Without in any way disagreeing with the Administration's premises that where a competitive marketplace exists, market forces will most efficiently allocate resources and yield the greatest net benefit to the economy and consumers as a whole, we must point out that the current bill contains critical flaws that preclude the accomplishment of such purposes. Rather than achieve a free market, the bill would perpetuate distortions arising from the ability of pipeline companies, which possess market power, to prevent independent producers of gas and consumers of gas in large segments of the consuming market from dealing with one another in a competitive marketplace. My testimony addresses these distortions which remain uncorrected by the Administration's proposal, and which would defeat the stated objectives of enhancing economic efficiency and of promoting competition. As discussed below, unless these flaws are addressed, the effect of this legislation would be to place an enormous "tax" primarily on residental and commercial consumers of natural gas that would unjustifiably further increase home heating bills above a market price and reduce gas consumption and net economic efficiency.

The "Open-Access" Transportation Proposal

The Department of Energy (DOE) correctly has stated that the market power of pipeline companies over essential bottleneck facilities, namely, the pipe essential to move gas from producing areas to market areas, has distorted the wellhead market, reduced competition and injured producers and consumers of natural gas. We strongly support the thrust of the Administration's proposals in Sections 101 and 102, which would require pipeline companies to transport gas in accordance with the Federal Energy Regulatory Commission (FERC) regulations governing self-implementing transportation by pipeline companies. The purpose of open access is to eliminate the monopoly that the pipeline has over the sales of gas and, instead, allow customers, like local distribution companies that purchase gas for residential and commercial consumers, to shop around among many pipelines or to purchase gas directly from the many producers or independent marketing companies.

As the Committee has observed, most interstate pipelines have failed to participate in Order No. 436 with the result that consumers are still unable to obtain transportation for gas purchased directly from producers. By section 102, the FERC would be able to remedy this situation by directing pipelines to offer transportation on non-discriminatory terms.

Nevertheless, the DOE proposal fails to achieve a truly "open-access" system of transportation; it would create greater access for one segment of the marketplace, namely, those large users that have the ability to switch from one fuel to another on relatively short notice (interruptible users) while withholding access to the competitive marketplace from residential and commercial consumers of natural gas until 1990.

The latter group -- residential and commercial consumers -- are what are called "firm" users of natural gas. That is to say, these customers have no alternatives to gas and therefore require that the delivery service provided by the pipeline company be on a reliable or non-interruptible basis. Pipelines have always been willing to provide transportation on a firm basis to distribution companies so long as the customer agreed to purchase gas from the pipeline as well. However, Order No. 436, while it provides for immediate non-discriminatory access to interruptible transportation services for gas purchased from others, allows the participating pipelines to retain their monopoly over sales to the residential and commercial market by phasing-in the requirement of firm transportation service over a five-year period.

Table 1 below shows the schedule under which Order No. 436 would allow pipeline companies to maintain a monopoly in sales of gas to the residential and commercial markets. As shown there, it is not until 1991 that the residential and commercial markets will obtain equal access to the competitive market place. The distinction in access afforded to firm and interruptible markets is crucial, because, as DOE has recognized, the prices charged by pipeline companies that are not subject to open access have been well above the prices available in the competitive marketplace.

Table 1

Opportunities for Pipelines to Pass through Above-Market Prices to Residential and Commercial Consumers Under the Administration's Proposal

Year	% of firm transportation capacity not accessible to gas supplied by others*
1986	85%
1987	70%
1988	50%
1989	40%
1990	25%
1991	0%

* Order No. 436-A, 50 Fed. Reg. 52217, 522274 (to be codified at 18 C.F.R. § 284.10(c) & (d)).

However justifiable a phase-in of non-discriminatory access to the transportation system might have been in the context of an administrative proposal of the FERC for a voluntary transportation program, it plainly is unjustified in a legislative proposal that purports to make comprehensive reforms to protect all consumers by reliance on free-market forces. The DOE proposal opens up the pipeline for access by large manufacturing plants while codifying the exclusion of residential and commercial consumers from the benefits of competition in the marketplace until 1991. To this extent, we are most vigorously opposed to this bill.

We urge the Committee to substitute for the DOE bill pertinent provisions of the bill introduced by Senator Bradley.[1] Under Senator Bradley's bill, local distribution companies purchasing for their system supply for use of their residential and commercial consumers would gain the same access to the marketplace for natural gas as would large manufacturing plants.[2] Under that proposal, unlike the DOE bill, the nation's consumers are not segmented into two camps: (1) the large manufacturing plants that are permitted to enter the competitive market place; and, (2) residential and commercial customers that are forced until 1991 to purchase gas -- at whatever price -- from pipelines that carry gas to that city. The same principles of the free market that require open access for some consumers require open access for all consumers.

In addition, the Bradley Bill, unlike the Administration's proposal, permits pipelines to reduce their purchase obligations to suppliers by an amount necessary to offset any reduction in volume of natural gas sold by the pipeline from its system supply due to transportation. S. 834, Section 316(e)(2), Vol. 121 Cong. Rec. S. 3851 (April 2, 1985). It is noteworthy that a similar provision giving pipelines take-or-pay relief where it lost sales to transportation was supported in the 98th Congress by among others, the Natural Gas Supply Association, Independent Petroleum Association of America and Natural Gas Equal Access. A copy of the Joint Statement of groups, including these organizations, supporting such a provision is attached. This Joint Statement, entitled "The Contract Carriage Coalition Compromise for Non-discriminatory Transportation," was widely circulated among the Senate and House Committees during the Second Session of the 98th Congress. There is no justification for excluding that provision from the Administration's Bill.

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[1] S. 834, Natural Gas Competition Act, Vol. 131 Cong. Rec. S. 3851 (April 2, 1985).

[2] E.g., Section 316(d), Obligation To Continue Service, Vol. 131 Cong. Rec. S. 3851.

NASUCA also urges that sections 101 and 102 make clear (as they presently do not) that all transportation must be undertaken pursuant to the terms of Order No. 436. While NASUCA believes that the FERC fell short of its statutory obligations to residential and commercial consumers in Order No. 436 in certain respects, which, as I explained earlier, should now be corrected, NASUCA believes that a pipeline should offer transportation services under a generic non-discriminatory program, such as Order No. 436, or not at all. Because the FERC recently has permitted interstate pipelines to offer blanket transportation pursuant to section 7(c) of the NGA without requiring the pipeline to comply with the requirements that the FERC found to be essential in Order No. 436 for blanket transportation to be considered nondiscriminatory, section 102 should be revised to make clear that all transportation must be conducted under uniform regulations.[3/]

For this reason, the draft bill should be clarified to ensure that all transportation provided by interstate pipelines be pursuant to the requirements of Order No. 436. Only in this way will the discrimination and anticompetitive behavior that the U.S. Court of Appeals in the *Maryland People's Counsel* cases found to result from the FERC's previous transportation programs be eliminated, and the salutory effects of competition be realized in the natural gas industry.

The Proposal to Deregulate Well-Head Prices

On first blush, the proposal to lift price controls for gas developed prior to 1977 that was not deregulated by virtue of the NGPA appears to be in keeping with free-market principles that would yield the expected benefits of competitive markets. But

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[3/] *Texas Gas Transmission Corporation*, Docket No. CP86-143-000, dated February 14, 1986. In *Texas Gas*, the FERC authorized transportation service to 52 end-users who, prior to October 31, 1985, had been receiving service either pursuant to authority under section 157.209 of the Commission's regulations or pursuant to the special marketing program (SMP) authority of some other gas company, which were vacated by the Court of Appeals in the *Maryland People's Counsel* cases as anticompetitive and harmful to consumers. *Maryland People's Counsel v. FERC*, 768 F.2d 768 (D.C. Cir. 1985) (remanding SMP I); *Maryland People's Counsel v. FERC*, 761 F.2d 780 (D.C. Cir. 1985) (vacating order 234-B); *Maryland People's Counsel v. FERC*, 768 F.2d 450 (D.C. Cir. 1985) (remanding SMP II). *Texas Gas* is unacceptable because it authorized interruptible service to some consumers without an obligation to provide firm service and, therefore, an opportunity for local distribution companies to gain meaningful access to suppliers other than the pipeline. In light of *Texas Gas*, the requirements of Order No. 436 have become merely options which pipeline may choose to ignore when it decides to offer "blanket" or "self-implementing" transportation.

such is not the case because of the particular way that DOE has shaped this proposal. As the DOE has recognized many times, one consequence of the partial decontrol brought about by the NGPA has been that below-market prices paid to producers for price-controlled, old gas permitted pipeline companies to pay above-market prices for gas that had been deregulated. Yet DOE now proposes to raise old gas prices to market levels while leaving new gas prices frozen at above-market levels.

The fact that new gas prices have been negotiated at above-market prices is well-documented by DOE and cannot be disputed. Over 40 percent of the current gas supply is old gas with an average price in 1985 of $1.44 Mcf, while the remainder is new gas with an average price of $3.78 Mcf.4/ The current market price, in contrast, is less than $2.00 Mcf. Some new gas is sold by producers directly to consumers on the free so-called "spot market." Gas sold on the spot market is sold at a market-price. The "new gas" sold by pipelines from their system supply, however, is sold to captive markets at prices dictated by long-term contracts that pipelines entered into during the period 1978 - 1983. During this period, pipelines, in reliance upon the below-market prices for old gas, agreed to purchase "new gas" at above-market prices. Under contracts which represent 52 percent of all NGPA Sections 102 and 107 new gas purchased by pipelines,5/ the

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4/ Natural Gas Monthly, DOE/EIA-0130 (86/01), 1986, at pp. 11-13.

5/ Foster Associates, Inc., "Analysis of High Cost Gas Purchases by Contract Termination Date" (Washington, D.C., August 1985, for
(footnote continued)

price is fixed by indefinite price escalator clauses that operate in one direction only. These escalators took the prices up to a level well above the current market price, or the long-run equlibrum price for natural gas, and froze them there. The result is that pipeline companies are contractually obligated to pay above-market prices for gas.

The distorting effect of this high-priced gas is likely to continue well into the 1990s because of the relative newness and long-term nature of the contracts. Of the current high-cost gas transactions without market-responsive pricing provisions, 76 percent are from contracts executed since the passage of the NGPA in 1978[6] and are predominantly long term. Only 13 percent of non-market-sensitive, high-cost purchase contracts will terminate before 1990, 61 percent will terminate between 1990 and 1995, while 26 percent are scheduled to terminate after 1995.

DOE proposes to remove the price controls on old gas, allowing those prices to escalate to a market-clearing price, without doing anything about the above-market prices for new gas under contracts that do not have price-sensitive adjustment provisions and that will not expire until the 1990s. The result of this proposal, if adopted, is that pipelines would become contractually obligated to buy at prices that are further above market levels than they are now. Although DOE recognizes that

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(footnote continued from previous page)
Policy Evaluation and Analysis Group, The American Gas Association) at p. 6.

[6] Foster Associates, supra, at p. 9.

this will occur, it reasons that market forces will drive those prices for gas under contracts to a market level. There are two problems with this reasoning. First, it ignores the fact that due to the limitations on access to pipeline transportation, such competition is available to reduce prices only to the segment of the market that is not held captive to purchase gas only from the pipeline company, as discussed in the transportation section above. Thus, between 1986 and 1990, due to the limits on access to firm transportation, pipelines could, and most assuredly would, pass through to residential and commercial consumers above-market prices for gas that, as a result of the DOE proposal, would be even higher than they would otherwise be.

Second, even if the discriminatory access problem were cured by adoption of the Bradley proposal, as we recommend, deregulating old gas prices without doing anything about the above-market prices under new gas contracts still would increase prices to consumers above a market-clearing level and would reduce demand for gas, production output and net economic effiency. This is so because even if open competition forced pipelines to purchase gas under market-insensitive contracts only at a market price, which it has not been wholly successful in doing in the past, the pipeline still would be contractually liable to the producer for the difference between the contract price and the market price. This contractual liability, though disputed, will have to be paid by someone. It is well documented by the FERC and the DOE, that the producers have not absorbed all of the disputed amounts. Rather, pipelines have made substantial payments to producers to settle some of these contracts.[7] DOE's proposal, even if modified to prevent the above-market prices from being passed through to residential and commercial consumers, would require that all of these contracts be settled. Old gas prices would rise to a market level. New gas prices under both market-sensitive and non-market-sensitive contracts would be reduced by competition to a market level, but pipelines would have to pay the producers holding the favorable non-market-sensitive contracts some portion of the difference between the market price and the contract price in settlement of the contract claims. And, pursuant to FERC policy, these settlement expenses would be passed through in the transportation charges to the captive consumer markets.[8] Thus, simply stated, the proposal would create a transfer of wealth from consumers to producers.

The magnitude of this wealth transfer is evident by comparing the price of old gas and new gas for a number of interstate pipelines. Table 2 below shows that, based on DOE data, the average price of old and new gas for twenty major pipelines is $2.77 Mcf, about $1.00 Mcf, or 56 percent, above the current spot-market price. Old gas prices average $1.39 Mcf, while new gas prices average $3.82 Mcf. It is obvious that permitting producers to raise some old gas prices to a current market price of $1.75 Mcf,[9] without reducing the obligation of pipelines to pay those producers less than the $3.82 due under contracts for new gas, can only raise prices or, if competition forces pipelines to refuse delivery of the higher-priced gas, increase contractual take-or-pay liability to producers. Either way, consumers will be forced to pay higher -- above market -- prices for gas as a direct result of raising old gas prices.

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[7] Federal Energy Regulatory Commission, Order No. 436, Final Rule and Notice Requesting Supplemental Comments, Docket No. RM85-1-000, issued October 9, 1985, at p. IV.B.12.

[8] See, for example, Order No. 436, 50 Fed. Reg. at 42442.

The extent of the wealth transfer will be greater on some pipelines than others, but in every case, consumers will pay more for gas than its market value.

9/ The price increase due to decontrol is not simply the difference between the market price and $1.39 Mcf, the average price of old gas. Rather, the price increase is equal to the difference between the market price and the average of only those old gas contracts that now are below the current market price. That average is well below $1.39. Under the Administration's bill, old gas that now is priced above market would be contractually fixed at the above-market price.

Table 2

Quantities and Average Prices for Wellhead Purchases of Natural Gas by Major Interstate Pipeline Companies 1984

	Old Gas NGPA §§ 104/106(a) Purchases			New Gas			
	Total Old Interstate Gas		Old Gas Quantity as a Percent of Total	All Other NGPA Sections		Total	
Pipeline Name	Quantity	Ave. Price		Quantity	Ave. Price	Quantity	Ave. Price
ANR Pipeline	296	1.54	62	182	4.40	478	2.63
Colorado Interstate Gas	145	0.80	53	127	3.61	272	2.11
Columbia Gas	183	2.37	31	401	4.67	584	3.95
Consolidated Gas Supply	40	1.60	23	133	3.72	173	3.23
El Paso Natural Gas	427	1.25	39	679	3.61	1,106	2.70
Florida Gas	58	0.85	28	149	3.55	207	2.80
K N Energy Inc.	51	0.82	65	27	3.41	78	1.71
Natural Gas	503	1.44	54	430	3.32	933	2.30
Northern Natural Gas	296	0.95	47	336	3.44	632	2.28
Northwest Central	159	0.97	63	94	4.07	253	2.12
Northwest	70	1.20	37	121	3.38	191	2.58
Panhandle Eastern	147	0.93	42	200	3.66	347	2.50
Southern Natural Gas	173	1.41	39	265	4.09	438	3.03
Tennessee Gas	420	1.80	49	430	3.88	851	2.85
Texas Eastern	287	0.70	40	437	3.50	724	2.39
Texas Gas	165	1.60	47	187	4.05	352	2.90
Transco	191	1.87	28	484	3.85	675	3.29
Transwestern	68	1.11	26	198	3.79	266	3.10
Trunkline Gas	169	1.82	53	147	5.64	316	3.60
United Gas	181	1.75	42	250	3.46	431	2.74
TOTAL	**4,029**	**1.39**	**43**	**5,276**	**3.82**	**9,305**	**2.77**

Source: Natural Gas Monthly, a DOE/EIA publication, January 1986, p. xxvi. The above pipelines serve such states as Colorado, Kansas, Oklahoma, Wyoming, New Jersey, New York, Pennsylvania, Maryland, the District of Columbia, Virginia, West Virginia, Ohio, Kentucky, Texas, New Mexico, Arizona, Nevada, California, Florida, Montana, Nebraska, Illinois, Indiana, Iowa, Missouri, Minnesota, Wisconsin, Michigan, South Dakota, Oregon, Idaho, Utah, Mississippi, Louisiana, South Carolina, Tennessee, Georgia, Alabama, Connecticut, Arkansas and North Carolina.

What effect would this wealth transfer have on consumers and on net economic effiency? First, clearly, consumers would be worse off, since their total bill would have risen even further above a market price. Second, the above-market prices to consumers will reduce demand for gas, thereby reducing production output and economic efficency.

This scenario can hardly be disputed by DOE. For in the last Congress, DOE proposed legislation to deregulate old gas prices but at the same time provided for the opportunity for new gas contracts to be renegotiated without any resulting contract liability and settlement payments. It did this by establishing a limited period of time during which either the seller of gas or the buyer of gas under such contracts could elect to terminate the arrangement if a satisfactory renegotiated substitute could not be arranged without contractual liability for doing so.[10] That approach properly reflected the clear reality that neither fairness to consumers nor economic efficiency can result from deregulating old gas prices without undoing the consequences of the new gas contracts that were negotiated at above-market levels in reliance upon continued price controls of that old gas.

The contrast between the Administration's bill in the last Congress and its current proposal clearly shows that the current bill reflects not a proposal to have free-market forces operate in the gas industry, but rather one to artifically prop up

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[10] S. 615, Cong. Rec. 1732 (Col. 2); Section 315 (Take-or-Pay Limits) and Section 316(a) (Market-Out Provision). Id. at 1735-1736, 1739.

prices to producers of natural gas at a time of falling oil prices. It is not a proposal to increase net economic efficiency, but, like the oil import tax proposal, is designed to protect the production industry from foreign competition, even though doing so would impair net economic efficiency. This proposal is far more damaging, however, to American consumers than was the oil import proposal, which at least would have spread the costs of subsidizing the production industry among consumers of all energy products. Here, in contrast, the burden of the subsidy is focused heavily and unfairly on a discrete segment of the population -- the residential and commercial consumers of natural gas that cannot, because of the high, fixed cost sunk in gas furnaces, take advantage of falling oil prices and escape the burden of above-market prices for natural gas that surely will befall them as a result of this unbalanced proposal.

If DOE is willing to stand up to the production industry, as the Administration did with respect to the oil import tax proposal, we will give every consideration to supporting modifications of the proposal to further true free-market objectives. But this proposal, which seeks instead unfairly to tax residential and commercial consumers with above-market prices for gas, is one we shall vigorously oppose. All those who are committed to the idea of substitution of free-market forces for regulation of the wellhead price should join us in opposition to the Administration's bill.

CONTRACT CARRIAGE COALITION COMPROMISE FOR NONDISCRIMINATORY TRANSPORTATION

A broad-based coalition of residential and industrial natural gas consumers, producers, and state utility regulators have agreed to support a legislative proposal for nondiscriminatory contract carriage. The compromise proposal is a hybrid of the McClure compromise language that is the subject of Senate negotiation and the Dingell/Sharp and Richardson/Broyhill bills. The compromise, which the coalition seeks to have included in any comprehensive gas bill, resolves certain concerns raised by some local distribution companies and pipelines about the contract carriage provisions now pending in the House and Senate. The proposal does not, however, address the question of whether transportation by local distribution companies should be subject to Federal jurisdiction.

Recent experience indicates that natural gas is now available for 10 to 30 percent less than pipelines are charging their customers. Yet pipeline refusal to transport gas to many distribution companies and end-users has prevented millions of gas customers from obtaining the benefits of lower gas prices. In addition, by facilitating the movement of gas supplies to meet demand, the contract carriage compromise will help to develop a competitive gas market which will force gas prices down to market clearing levels.

The reduction in gas prices will also increase the use of natural gas. By putting pipelines' idle capacity to productive use, the per unit cost of gas to all consumers will be reduced. Thus, the effect of competition in the natural gas markets, combined with increased usage of pipeline facilities, will result in significant consumer savings.

Set forth below is a description of the key provisions of the compromise which compares it to the House and Senate proposals.

1. Definition of Available Capacity

a. Senate (McClure) bill: Would limit the capacity which is available for contract carriage service to that pipeline capacity in excess of the capacity necessary to meet all maximum quantities under all tariffs, licenses or certificates. In addition, under this bill, a proposed contract carriage customer could get access to pipeline capacity to the extent either (i) an local distribution company is obligated to provide the contract carriage customer service without interruption or (ii) the state agency or local distribution company authorizes the contract carriage customer to utilize capacity otherwise reserved to the local distribution company.

b. House bills: The Dingell/Sharp bill would leave to the FERC the determination of when a pipeline has available capacity, whereas the Richardson/Broyhill bill states that in determining whether available capacity exists, the FERC must take into account the sales volumes for current customers and those reasonably projected for the requested transportation period.

c. Compromise: The determination of available capacity provision would be the same as the Senate bill, but in addition the prospective contract carriage customer would be able to obtain interruptible capacity to the extent of the greater of the (i) difference between the pipeline's total capacity and average actual throughput over the previous three years or (ii) the difference between the pipeline's total capacity and reasonably foreseeable requirements of its existing customers. In addition, any contract carriage customer receiving interruptible service would be able to obtain firm service whenever firm capacity is available. Subsection (d).

2. Restrictions on by-passing local distribution companies.

a. Senate (McClure) bill: Would restrict the by-passing of local distribution companies for facilities historically served by the local distribution company unless the transportation has been agreed to by the state and the local distribution company. A facility that has received service within the past four years and is physically connected to a local distribution company would be deemed to be historically served.

b. House bills: The Richardson/Broyhill bill would subject any by-pass to an FERC Section 7 proceeding. In addition, in the Dingell-Sharp bill, the relevant state commission would be authorized to impose terms and conditions on the transportation.

c. Compromise: A facility that has been served during the past four years would not be permitted to bypass a local distribution company unless the state agency approves or the volumes are in excess to the maximum volumes sold during the past four years. This restriction on by-pass would not apply if (i) the state does not have a procedure under which the state agency will, within a time certain, require local distribution companies to provide nondiscriminatory transportation to the extent of available capacity or (ii) the state finds the local distribution company does not have sufficient capacity to transport the gas. Subsection (c).

3. Additional Changes

There are several additional provisions in the compromise bill included for the purpose of creating nondiscriminatory contract carriage while protecting pipelines, local distribution companies and their existing customers.

a. Prerequisites to obtaining transportation: The compromise would eliminate the burdensome preconditions that were in the Senate bill (i.e. that the contract carriage customer must show it was unable to find other satisfactory arrangements before it can obtain transportation and that it has made a good faith effort to negotiate a continuation of current service). Subsections (a) and (b).

b. Who can obtain transportation: The compromise would open transportation and storage service to all contract carriage customers described broadly to include producers, sellers, resellers, buyers, local distribution companies, owners, users, or agents thereof. Subsection (o)(4). The Senate bill would limit service to sellers or purchasers.

c. Contract carriage compensation: As in the Richardson Broyhill bill, the compromise would provide that pipelines can receive an "incentive allowance" of up to 3 cents per Mcf (5 cents if there are multiple pipelines) if the pipeline does not file an unreasonable protest. The incentive allowance would be in addition to a just and reasonable rate which would include an equitable percentage of the pipelines' fixed costs. The compromise would also include the provision contained in the House bill which permits a pipeline to charge less than its maximum allowable rates provided it does not discriminate and does not recoup the cost from other customers. Subsection (b)

d. Tying-up of capacity: The compromise would incorporate the House bill provisions on termination and reduction of allocated capacity, but makes clear that local distribution companies do not lose the contract carriage capacity allocated as a consequence of switching from system supply capacity. Subsection (l). The compromise bill would also contain a provision to prevent those requesting contract carriage service from unreasonably tying up capacity (in effect transferring the monopoly over transportation from the pipeline to another entity).

e. Take-or-pay relief: The compromise would permit a pipeline to reduce its take-or-pay obligations, ratably among all its purchase contracts, in the event the pipeline loses sales volumes due to contract carriage services.

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Coalition members supporting the Contract Carriage compromise include:

- Illinois Commerce Commission
- National Association of State Utility Consumer Advocates (an association of the legal representatives of residential and commercial consumers in 39 states)
- Natural Gas Equal Access (a coalition of independent gas producers and trade associations)
- Committee for Equitable Transportation (a coalition of industrial gas consumers)
- Independent Petroleum Association of America
- Natural Gas Supply Association

Senator NICKLES. Thank you, Mr. Legato.

Mr. Stewart.

STATEMENT OF ROBERT W. STEWART, CHAIRMAN, PRIMARK CORP.

Mr. STEWART. Mr. Chairman, it is a pleasure to be seeing you, again, today. I have but one point I would like to make and I think it is an important point for the committee's consideration, and that point is that the gas industry and its customers will never enjoy the benefits of free and competitive market unless the Congress mandates transportation on a nondiscriminatory basis for the interstate natural gas pipelines.

We feel that the DOE proposal to deregulate old gas, although it contains provisions related to pipeline transportation, we don't think it provides for mandatory, nondiscriminatory transportation.

If Congress should act to deregulate old gas but fails to enact nondiscriminatory mandatory transportation, then you are simply going to enrich a few major producers at the expense of the paying public. At the same time, we do think that mandatory, nondiscriminatory transportation can be easily legislated by simply adopting the provisions of order 436 and making them mandatory under the law.

It would be highly desirable to have open transportation, mandatory, nondiscriminatory, open transportation in effect at least 6 months prior to the effective date of deregulating old gas prices.

Thank you, Senator.

[The prepared statement of Mr. Stewart follows:]

STATEMENT OF ROBERT W. STEWART
CHAIRMAN, PRIMARK CORPORATION
BEFORE THE
SENATE SUBCOMMITTEE
ON
ENERGY REGULATION AND CONSERVATION
APRIL 15, 1986

CHAIRMAN NICKLES, COMMITTEE MEMBERS, LADIES AND GENTLEMEN. MY NAME IS ROBERT W. STEWART. THANK YOU FOR THE OPPORTUNITY TO TESTIFY TODAY ON BEHALF OF MICHIGAN CONSOLIDATED GAS COMPANY AND ITS CUSTOMERS.

MICHIGAN CONSOLIDATED IS THE NATION'S FIFTH LARGEST GAS DISTRIBUTION COMPANY SERVING MORE THAN ONE MILLION RESIDENTIAL, COMMERCIAL AND INDUSTRIAL CUSTOMERS THROUGHOUT MICHIGAN. MICHCON IS ALSO THE LARGEST SUBSIDIARY OF PRIMARK CORPORATION, OF WHICH I AM CHAIRMAN.

Six months ago I appeared before this committee to express MichCon's support for the Federal Energy Regulatory Commission's (FERC) proposed rulemaking, which resulted in Order 436. Today I am here to reiterate MichCon's support for the principles embodied in Order 436 -- a more open, competitive and market-responsive gas industry. And, in addition, to express our opposition to the decontrol of "old" gas prices, in the absence of a market-responsive industry.

In reviewing the legislation being considered by this committee -- including the Administration's bill -- I would say that the vision of a competitive, market oriented gas industry is shared by us all; an industry where competition at the wellhead means the least costly gas for consumers and a fair price for producers. However, progress towards this goal has been very slow, coming amid loud protests.

DURING THE PAST SIX MONTHS, MOST PIPELINE COMPANIES HAVE RESISTED OFFERING THEIR CUSTOMERS NON-DISCRIMINATORY TRANSPORTATION SERVICES; CLEARLY AN ADMISSION THEY CANNOT, OR WILL NOT, COMPETE AGAINST THEIR OWN PURCHASED GAS COSTS.

THE GAS INDUSTRY IS STILL PLAGUED BY ITS INABILITY TO MOVE LOW-COST GAS TO MARKET AT SUBSTANTIAL SAVINGS TO CONSUMERS; BY PRODUCER/PIPELINE CONTRACTS FOR HIGH-COST GAS SUPPLIES THAT ARE CLEARLY UNMARKETABLE; BY SHUT-IN GAS SUPPLIES THAT COULD BE MARKETABLE; AND BY A CONTINUING LOSS OF MARKETS TO COMPETITIVE FUELS. AFTER EIGHT YEARS OF DWINDLING MARKETS AND FOUR YEARS OF SURPLUS SUPPLY, WE STILL FIND LARGE SEGMENTS OF THE GAS INDUSTRY REFUSING TO FACE THE REALITIES OF A COMPETITIVE MARKETPLACE.

ANY LEGISLATION ADOPTED BY THIS COMMITTEE SHOULD FIRST AND FOREMOST MANDATE NON-DISCRIMINATORY, OPEN ACCESS TRANSPORTATION AND CONTRACT DEMAND REDUCTION AND CONVERSION OPTIONS AS SPELLED OUT IN FERC ORDER 436 AS APPROVED ON OCTOBER 9, 1985. SUCH ACTION WOULD EXPOSE INTERSTATE PIPELINES TO COMPETITIVE PRESSURES, REQUIRING THAT THEIR OPERATIONS BECOME MORE MARKET-EFFICIENT AND CONSUMER RESPONSIVE. THAT IS ESSENTIAL.

THE ABILITY FOR PRODUCERS AND CONSUMERS TO FREELY INTERACT IN THE MARKETPLACE IS ABSOLUTELY NECESSARY IF WE'RE TO ESTABLISH NATURAL GAS PRICES THAT ARE LEGITIMATELY MARKET BASED. THERE ARE FEW SUCH OPPORTUNITIES TODAY. WHERE THE SPOT MARKET HAS BEEN GIVEN A CHANCE TO FLOURISH, GAS PRICES FELL AN AVERAGE OF 25 PERCENT DURING 1985. THIS MONTH, GAS CAN BE PURCHASED ON THE SPOT MARKET FOR UNDER $1.50/MCF IN TEXAS AND LOUISIANA.

FORECASTS GENERALLY HAVE PRICES FALLING FURTHER THIS YEAR. HOWEVER, GAS UNDER CONTRACT TO INTERSTATE PIPELINES HAS NOT EXPERIENCED A SIMILAR PRICE DROP. IN THE FACE OF FALLING OIL PRICES AND THE POTENTIAL FURTHER EROSION OF SALES IN INDUSTRIAL AND LARGE COMMERCIAL MARKETS, THIS JUST DOES NOT MAKE ECONOMIC SENSE.

IN SHORT, PIPELINES ARE STILL LARGELY INSULATED FROM BUSINESS RISKS. CURRENT REGULATIONS PROVIDE LITTLE INCENTIVE TO PIPELINES TO OPEN THEIR SYSTEMS ON A NON-DISCRIMINATORY BASIS. ONLY SEVEN PIPELINE COMPANIES, INCLUDING MICHCON'S TWO MAJOR SUPPLIERS, ANR PIPELINE AND PANHANDLE EASTERN PIPELINE, ARE SERIOUSLY CONSIDERING OFFERING THEIR CUSTOMERS OPEN TRANSPORTATION SERVICES. AND MANY PIPELINES ARE SEEKING TO CIRCUMVENT OPEN TRANSPORTATION BY ARRANGING NATURAL GAS ACT, SECTION 7(C) AGREEMENTS WITH SELECTED CUSTOMERS. IN ESSENCE, THEY'RE BURYING THEIR HEADS IN THE SAND.

THE ADMINISTRATION'S BILL DOES NOT MANDATE NON-DISCRIMINATORY TRANSPORTATION AND, THEREFORE, DOES NOTHING TO ENCOURAGE A MARKET RESPONSIVE INDUSTRY. THE BILL MERELY PERMITS THE FERC TO ORDER NON-DISCRIMINATORY TRANSPORTATION AFTER FULL HEARINGS. THE BILL DETRACTS FROM FERC'S ORDER 436 WHICH HAS ALREADY BEEN THROUGH NINE MONTHS OF HEARINGS.

UNDER THE ADMINISTRATION'S PROPOSAL, REQUESTS FOR NON-DISCRIMINATORY TRANSPORTATION WILL HAVE TO BE SUBJECTED TO THE SAME LENGTHY HEARINGS ON A PIPELINE-BY-PIPELINE BASIS. WE MAY NEVER REALIZE A TRULY NATIONAL NON-DISCRIMINATORY TRANSPORTATION SYSTEM AND CONSUMERS WOULD NOT REALIZE THE SUBSTANTIAL SAVINGS SUCH A SYSTEM PROMISES.

Last year MichCon purchased 50 billion cubic feet (Bcf), 15 percent of our annual supply, in the spot market. These purchases produced a direct savings to customers of $10 million because they were made at prices below our pipeline suppliers' commodity charges in affect last summer. It also produced additional savings by putting pressure on our largest pipeline supplier to reduce their rate by 50¢ per Mcf, saving customers an additional $100 million.

Assuming the contract demand reductions in Order 436 are adopted, MichCon could further reduce cost -- by as much as $75 million annually -- by shedding the demand cost for approximately 80 to 100 billion cubic feet of unused pipeline capacity. And additional access to the spot market could increase annual savings to more than $100 million.

MichCon's customers -- like all natural gas consumers -- expect us to provide natural gas service at the lowest price practicable. They demand it. They also expect regulators and legislators to represent their interest and do the same. However, existing regulations which insulate pipelines from market realities have only resulted in consumers paying artificially high prices.

State regulators scrutinize the practice of local distribution companies and federal regulators at FERC examine pipeline practices, but the gas purchase negotiations between pipelines and producers have been allowed to go on at arms length. In fact, Section 601 of the Natural Gas Policy Act of 1978 (NGPA) restricts regulatory scrutiny of pipeline purchasing practices.

This has to change. Not by regulating purchasing practices, but by increasing the number of buyers and sellers that can compete in the wellhead market. By encouraging competition for customers through the delivery of low cost gas supplies.

THE DECONTROL OF "OLD" GAS PRICES DOESN'T ENSURE CONSUMERS OF THIS ESSENTIAL COMPETITION. UNDER CURRENT REGULATORY AND ECONOMIC CONDITIONS, WELLHEAD PRICE DECONTROL WOULD SIMPLY RESULT IN AN INCOME TRANSFER FROM CONSUMERS TO A FEW LARGE PRODUCERS. IT WOULD MAKE A BAD SITUATION, WORSE.

OLD GAS DECONTROL ASSUMES A TWO-STEP FIX OF HIGH GAS PRICES. THE FIRST STEP WOULD BE TO RAISE THE PRICE OF OLD GAS. THIS IS EXPECTED TO ELICIT RENEGOTIATION OF HIGH COST, HIGH TAKE-OR-PAY, NEW GAS CONTRACTS AND, OVER TIME, PRODUCE MARKET RESPONSIVE PRICES THEREBY, LOWERING PRICES TO CONSUMERS.

HOWEVER, IN THE ABSENCE OF NON-DISCRIMINATORY GAS TRANSPORTATION, THE CONSUMER HAS VIRTUALLY NO OPPORTUNITY TO INTERACT IN THE WELLHEAD MARKET AND EFFECTIVELY RESTRAIN "OLD" GAS PRICES AND ENSURE THE FINAL PRICE IS MARKET RESPONSIVE.

THE IMMEDIATE RESULT WILL BE HIGHER PRICES FOR ALL GAS, SINCE LOWER PRICED OLD GAS WILL, BY DESIGN, BE REPRICED AT A HIGHER LEVEL OR REPLACED BY OTHER, HIGHER PRICED GAS. THE ENERGY INFORMATION ADMINISTRATION'S (EIA) RECENT ANALYSIS OF CONTRACTS FOR OLD INTERSTATE GAS POINTS OUT THAT CHANGING THE CEILING PRICE OF OLD GAS WILL DO NOTHING TO MAKE THOSE CONTRACTS MARKET-RESPONSIVE.

THE ONLY ADDED PRESSURE ON A HIGH COST PRODUCER THAT WOULD RESULT FROM DECONTROLLING OLD GAS WOULD COME FROM A FURTHER REDUCTION IN DEMAND IN THE ENTIRE GAS MARKET DUE TO HIGHER PRICES. TRY AS ONE MIGHT, IT IS AN UNAVOIDABLE ECONOMIC FACT THAT RAISING PRICES IN A TIME OF EXCESS WILL ONLY EXACERBATE THE EXCESS.

WITHOUT NON-DISCRIMINATORY, OPEN ACCESS TRANSPORTATION IN PLACE, I SEE LITTLE IN "OLD" GAS DECONTROL LEGISLATION THAT HOLDS PROMISE FOR A MORE MARKET-RESPONSIVE GAS INDUSTRY AND LOWER GAS PRICES FOR CONSUMERS.

IN CONCLUSION, I BELIEVE CURRENT NATURAL GAS TRANSPORTATION PRACTICES UNNECESSARILY RESTRICT THE ABILITY OF WILLING BUYERS AND SELLERS OF NATURAL GAS TO INTERACT IN THE MARKETPLACE, RESULTING IN SHUT-IN SUPPLIES FOR PRODUCERS AND HIGH PRICES FOR CONSUMERS. CONGRESS' FIRST PRIORITY, WHEN IT COMES TO THE GAS INDUSTRY, SHOULD BE TO MANDATE NON-DISCRIMINATORY TRANSPORTATION FOR NATURAL GAS. CONGRESS CAN ACCOMPLISH THIS SIMPLY BY ORDERING PIPELINES TO COMPLY WITH ORDER 436 WHICH HAS ALREADY BEEN APPROVED BY THE FERC.

SUCH ACTION WOULD ACHIEVE TWO OF THIS COMMITTEE'S APPARENT GOALS. IT WOULD:

-- ENCOURAGE COMPETITION AMONG NATURAL GAS SUPPLIERS TO PROVIDE CONSUMERS WITH GAS AT THE LOWEST REASONABLE PRICE, AND

-- PROVIDE PRODUCERS WITH ACCESS TO THE MARKET AT FAIR PRICES, ESTABLISHING AN INCENTIVE FOR CONTINUED EXPLORATION AND PRODUCTION OF NATURAL GAS.

THESE ARE THE ESSENTIAL COMPONENTS OF THE COMPETITIVE ENVIRONMENT WE NEED IF WE ARE TO BRING ABOUT A LONG-TERM BALANCE IN THE GAS INDUSTRY. THESE ARE ALSO THE ESSENTIAL COMPONENTS THAT WILL STOP THE PRICE DISTORTIONS THAT ARE ADVERSELY AFFECTING PRODUCERS AND CONSUMERS ALIKE.

THANK YOU.

Senator NICKLES. Mr. Stewart, thank you, very much for your comments.

Mr. Bagge.

STATEMENT OF CARL E. BAGGE, PRESIDENT, NATIONAL COAL ASSOCIATION

Mr. BAGGE. Mr. Chairman, I am here to express the interest and the concerns of the coal industry in this proposal. I have a prepared statement I would like to present for the record, which deals with the broader aspects of the bills, including yours, and the broader issue of gas decontrol.

I would like to, if I may, however, just take the time that I am allotted to discuss an issue that really outcropped during the course of the dialog here this morning and that is the existing provisions of title 2, section 2012, embraced in the current Fuel Use Act, which holds that in cases of the utility sector—not the industrial sector, but in the utility sector, and that alone, when you are dealing with a commitment for baseload utility plants that are going to be committed for a period of approximately 35 to 40 years, it is our view, in the coal industry that although we agree—as I say in the statement—that this madness we call price regulation of gas, ought to go by the boards.

We also agree with the thrust of your bill which respects specifically FUA, except in the regard that we believe that in the interests of our industry, I say, very frankly, national policy, that Congress ought to act very carefully before it eliminates a provision that will provide for the full optimization of fuel use in baseload utilities for the long term.

I think that your dialog with Mr. Harlow illustrated that. The fact that he had the ability to switch when the price was right. All we are pleading for here is that some consideration be given to keeping in place, as an element of national policy, the provisions that would require some degree—and I underscore "some degree" of coal capability in baseloaded utility plants for the future, so that because of the vagaries of pricing, which we have seen only in the recent past, that the utility industry will have the ability to turn again back to coal, or to switch.

I make the additional point, I think that you have already discussed this, that if you commit to a gas-fired boiler, it can't burn coal, but a coal-fired boiler has the capacity to burn any other fossil fuel, and that ought to be an important element in your deliberations.

I think therefore in some ways, the coal industry supports the proposition of gas decontrol. We support all the other elements of your bill, that in the case of the utility sector—I say, again, that the provisions which exist now in section 2012 ought to be maintained in place as a matter of overriding national policy, and also to compensate for the built-in institutional and regulatory bias that would otherwise exist in the minds of the PUC's, with the notable exception of the chairperson of the Illinois commission who indicated that she has an interest, their commission has an interest in keeping coal capability—but, for a PUC in a coal-producing State, I submit that there are institutional and other biases against commiting the chief executive officers of the utility companies of this Nation to add that additional increment of capital investment—whatever it is—and we can discuss the amount of that, depending on how you define coal capability.

We have no rigorous definition—this could be worked out. But it seems to me that absent a Federal policy that retains that vestigial remain the BFUA in place, there is an institutional and regulatory bias against a utility opting for maximizing of the interests—the long-term interests of their utility ratepayers, optimizing the choice of fuel over a 40-year period. And with that, I think that is a responsible position for my industry. I submit it to this committee and the Congress for your serious consideration and hope we can work something out.

[The prepared statement of Mr. Bagge follows:]

NATIONAL COAL ASSOCIATION

Statement of

Carl E. Bagge
President
National Coal Association

before the

Subcommittee on Energy Regulation and Conservation
U.S. Senate Energy and Natural Resources Committee

April 15, 1986

Mr. Chairman, I'm Carl Bagge, President of the National Coal Association. Thank you for giving me the opportunity to appear today and give the coal industry's views on the Powerplant and Industrial Fuel Use Act (PIFUA) and proposed changes to that Act such as those contained in S. 2205. I will be brief and confine myself to those portions of the Act that affect the use of natural gas.

Mr. Chairman, as you know, PIFUA was passed at the height of the energy crisis hysteria, and I believe a lot of confusion still exists over what the Act does and does not allow in terms of natural gas usage. The key point is that existing boilers face absolutely no legal or regulatory barriers to the use of natural gas.

- First, as you know, the so-called "off-gas" provision applying to existing boilers of PIFUA was repealed in 1981, which was the major force in the Act to move large amounts of gas out from under large industrial and utility boilers.

- Hence, the only PIFUA restriction is the one that prevents the use of natural gas in new boilers. PIFUA also requires those boilers to be built "coal-capable."
- Third, this requirement does not appear to be presenting a real problem for those new plants desiring to use gas, given the various exemptions in the law which are routinely granted by the Department of Energy.

Mr. Chairman, any such reexamination of PIFUA should take into account three fundamental forces impacting today's energy markets. First, the current regulatory environment of second guessing utility decisions, primarily at the state level, is resulting in a growing aversion of electric utilities to building new capital-intensive coal-fired coal plants, which, over the life of the plant, is clearly the cheapest alternative. Instead, less capital-intensive gas-fired plants are being used to meet new demand. While such power plants might be economic at today's natural gas prices, few expect these price relationships to hold over the next two, three or even four decades, which is the lifetime of these power plants. Repeal of PIFUA would undoubtedly hasten this trend to less capital-intensive but more fuel-intensive generating facilities in this country.

Second, as a sheer engineering matter, once a boiler is built to burn gas only, it cannot be converted to use other fuels, principally coal. The opposite is not true -- a coal-capable boiler can be rapidly and inexpensively converted to use gas. The architects of PIFUA in the previous administration learned this painful lesson in the early days of the infamous "coal conversion" programs of the mid 1970s, when natural gas supplies were rapidly dwindling, and much of the generating capacity simply could not be converted.

Third, the domestic and international energy markets have been for the last decade and most likely will continue in the future to be highly volatile. While the price of gas relative to coal has recently turned favorable, returning more to the historic relationships of the early 1970s, most observers, including non-experts such as myself, expect the relative price of gas to resume its climb sometime in the not too distant future.

For these reasons, Mr. Chairman, I believe it is absolutely essential for formulators of national energy policy such as yourself to carefully consider the future impacts of any decisions made today that are based upon the vagaries of the current price and supply situation. Repeal of the requirement that new boilers be coal-capable is, in my view, not warranted and most likely will be viewed as a mistake in the future, since current regulatory and price relationships will inevitably lead to a stock of generating capacity that is incapable of responding to future changes in energy supply and demand.

Mr. Chairman, I can offer you the full assistance of the coal industry to the task you and your colleagues face today. I thank you very much for this cpportunity to appear today.

Senator NICKLES. Mr. Bagge, thank you, very much for your comments.

Mr. WILLIAMSON.

STATEMENT OF DELBERT G. WILLIAMSON, VICE PRESIDENT AND GENERAL MANAGER, TURBINE MARKETING, GENERAL ELECTRIC CO.

Mr. WILLIAMSON. Thank you, Mr. Chairman. I represent the General Electric Co.'s turbine business group, who manufacture both gas and steam turbines for the electrical utility, industry, and Navy propulsion business. Hopefully, I can describe a concept that is a compromise between both sides of the issue, as Mr. Bagge just pointed out.

As you are aware, U.S. utilities have not been adding much generation capacity in recent years. This is due primarily to reduced load growth and uncertainties in the fuel availability, price, rate of load growth, and economic swings of the early 1980's, and many of the new environmental and regulatory regulations.

Among these uncertainties is the effect of the Fuel Use Act under discussion today which restricts the use of oil and gas in new electric powerplants. Electric utility load growth has declined from a steady 7 percent annual rate prior to the early 1970's, to a rate of only 2 to 2.2 percent this year. However, since 1978, when the Fuel Use Act was passed, fuel supply has increased and the price of these fuels have dropped significantly, and our nationwide utility surveys and demand projections show that any present excess electric capacity will likely disappear by 1992 to 1993.

We believe that the appropriate response is to make it possible for the utilities to be able to adopt clean, coal capability power generation systems that can be added in small incremental steps and that have a high degree of fuel flexibility.

One proposed solution is called Progen, which stands for progressive generation. This concept allows utilities to install a gas turbine powerplant as a first step, and later, as needed, add heat recovery steam generators and steam turbines to form a high-efficiency electric generating system known as a combined cycle.

The system initially uses oil or natural gas, but has the flexibility to add a coal-gasifier to provide an environmentally superior, economic coal-burning powerplant in the future. Combined cycles have many advantages, chief among them being high efficient—44 to 46 percent, compared to 38 percent for a steam electric powerplant fired either from coal or gas, and only 32 percent for combustion gas turbine by itself.

Adding heat recovery boiler and steam turbine typically increases plant output by one-third with no additional fuel consumed. Also, the price is two to three times less per kilowatt than a steam electric plant—for example, $450 a kilowatt for combined cycle, versus $1,200 to $1,400 per kilowatt for a coal plant.

The environmental performance is superior, installation time is much shorter, and with time estimated for plant operation in 1 to 3 years, versus up to 8 years for a coal-steam plant, and the plant is modular and can be expanded as needed, which allows for planning from the financial standpoint, as well.

Most importantly, it has the multiple fuel flexibility and is capable of using oil, natural gas, or coal-derived fuels. The coal gasification system can be added at any time at a total cost that can be competitive with conventional coal-fired powerplants.

The Fuel Use Act discouraged utilities from installing combined cycle plants by making it almost impossible to obtain a permit for a utility plant. In fact, the last combined cycle plant installed in the United States was in 1981, in Massachusetts.

These plants have since been sold throughout the world, in Turkey, Pakistan, Taiwan, Argentina, Trinidad, China, and now, 2,000 megawatts to Toyko Electric Power Co.

Japan is the toughest environmental and has the toughest efficiency requirements in the world, and is still investing $1.2 billion on this technology.

General Electric has been a prime sponsor and participant in the 100-megawatt coolwater coal gasification combined cycle demonstration plant installed and operating successfully in southern California for the last 2 or 3 years. This plant was built since the 1978 act was installed, ahead of schedule, and only 2½ years at below its indicated predicted cost, and has demonstrated very environmentally low emissions and excellent performance, while operating on a variety of different coals.

We recommend the repeal of those sections of the Fuel Use Act that preclude utilities from using gas or oil in new intermediate or baseload electric power generation facilities. As a minimum, we urge that the act be modified to permit utilities to install high efficiency, coal-capable, state-of-the-art combined cycle plants to provide our future generation needs.

This would ensure that all new powerplants utilizing natural gas or oil will be operated in the most efficient and least-costly manner. Thank you.

[The prepared statement of Mr. Williamson follows:]

STATEMENT BY DELBERT G. WILLIAMSON

BEFORE THE

SENATE COMMITTEE ON ENERGY AND NATURAL RESOURCES

SENATE SUBCOMMITTEE ON ENERGY REGULATION & CONSERVATION

APRIL 15, 1986

My name is Delbert G. Williamson, and I am Vice-President and General Manager of the General Electric Turbine Marketing headquartered in Schenectady, New York. We manufacture combustion and steam turbines for electric utility, navy marine propulsion, and industrial applications in Schenectady, New York, Greenville, South Carolina and Lynn, Massachusetts. We have held a leading role in this market in the United States and around the world over the last several decades.

We have been in the turbine business for more than 50 years and our success has been dependent on the products we offer and on the strength of the markets we serve. As you are all aware, the U.S. utility markets have been on hold since the Arab oil shocks of the 1970's. This situation is the result of reduced electricity demand and uncertainities in fuel availability and price, concerns regarding public utility commission approval of regulations affecting power plants and power generation equipment. Among these uncertainities, the Powerplant and Industrial Fuel Use Act of 1978 specifically place restrictions on the use of oil and natural gas in new electric powerplants. The high efficiency combined-cycle system consists of a combustion turbine to generate electric power, with its exhaust heat directed to a heat recovery steam generator. This boiler generates steam from the combustion turbine exhaust heat, which is then used to drive a steam turbine to produce additional electric power, but with no additional fuel than was used in the combustion turbine. The efficiency of this system is about 20% higher than a conventional coal-steam plant (45% vs. 38%).

Following the 1973-74 Oil Embargo, the General Electric Company initiated extensive design and systems trade-off studies of alternative coal-capable electric power generation systems. General Electric also participated in similar studies funded by the Energy Research and Development Administration and by the Electric Power Research Institute. In addition, the company conducted extensive research and development, under contract to the Government and EPRI, on advanced power generation systems such as, pressurized fluidized bed combustion systems, molten carbonate fuel cells and magnetohydrodynamics. The results of this work clearly indicated that the integrated gasification combined cycle power plant system had a high potential for clean, low cost and efficient utilization of coal in the generation of electricity. These encouraging results led General Electric to become a prime sponsor and participant in the 100 MW Cool Water integrated coal gasification combined cycle demonstration plant installed in the Southern California Edison facility at Dagget, California. This plant has demonstrated very low environmental emissions and excellent performance while operating on a variety of different coals. The plant was installed in only two and a half years and was below its predicted cost.

The energy situation today is dramatically different than it was at the time the Powerplant and Industrial Fuel Use Act was enacted. Both gas and oil are readily available and the price of these fuels have dropped substantially, particularly in the past several months. At the same time, electric utility load growth has declined from a relatively steady 7% annually during the era from the 1980's to the early 1970's to a rate of about 2.0 - 2.2% this year. These dramatic changes have severely battered the U.S. utility industry. The result is that utilities are reluctant, and have little incentive, to make commitments to replace aging generation facilities or to add capacity even if growth projections indicate the need to do so.

Nationwide utility surveys we have conducted, and demand projections made by others, indicate that the excess electric capacity that now exists will disappear by 1992. In order to meet these demands, utilities must begin to place orders in 1986 and 1987 so that manufacturing capacity can be committed for units that would commence operation before an energy shortfall occurs. We firmly believe that the appropriate response is to make it possible for the utilities to adopt clean, coal-capable power generation systems which can be added in small incremental steps and which have a high degree of fuels flexibility. One such concept we call PROGEN, which stands for Progressive Generation. The progressive concept allows utilities to install a combustion turbine power plant as the first step, with provisions made to add a heat recovery steam generator and steam turbine as a second step. The system can burn available natural gas or oil in these first two phases of construction, but most importantly, a coal gasification plant can be added to convert the plant to a highly environmentally acceptable, economical, coal burning power plant. At the outset, utilities must make provisions at the plant site for future coal storage and handling facilities, and for the gasification plant. We believe that this incremental, stepwise process will encourage utilities to get started earlier and can potentially accelerate the use of coal for power generation.

The combustion turbine by itself can be installed quickly, -- in many cases in about 1 year --, and inexpensively, at a cost of about $200 per kilowatt (compared to $1200 to $1400/KW for a conventional coal electric plant), providing the lowest cost approach to generation that is demanded by both Public Utility Commissions and utility customers. The plant operates to most peak leads, and if no further load growth occurs, it would continue to operate in the peaking mode for up to 1500 hours per year. This type of operation is permitted under the present peak load exemption available under the Fuel Use Act, and the Economic Regulatory Administration processes such applications in an expeditious fashion. However, a problem arises when the utility wants to increase output and improve the fuel efficiency of the plant because of increased load demands, by adding the heat recovery steam generator and steam turbine. The output of the plant typically increases by 1/3 and the efficiency increases by a like amount because no additional fuel is consumed. When the Powerplant and Industrial Fuel Use Act was written, there were concerns that the efficiency of the combined-cycle would make them very attractive to utilities, and thus, the use of oil or natural gas by such plants would increase. As a result, the provisions of the existing Law make it almost impossible to obtain a permit for a combined-cycle power plant. In fact, the last such plant to be installed in the United States was by the Massachusetts Municipal Wholesale Electric Company in 1981. A section of the Fuel Use Act grandfathered that plant from its prohibitions.

Conversely, since 1981 GE has sold combined-cycle systems to Taiwan, Argentina, Trinidad and Tobago, China and 2000MW to Tokyo Electric Power. The Japanese have the world's toughest environmental and efficiency requirements and they are investing more than $1.2 billion in a technology that is essentially forbidden by law in the United States. The Tokyo plant is scheduled to go on line this year.

The beauty of the PROGREN approach to combined-cycle additions is that a coal gasification system can be added to the operating combined-cycle. Hence, we have a system whose individual parts can be installed as needed, allowing a utility to spend controlled amounts of money in a way that emphasizes efficiency and environmental performance, and which, because of its fuel flexibility and coal-capability, ensures that the plant will provide the lowest cost electric energy throughout its useful life.

We recommend the repeal of those sections of the Powerplant and Industrial Fuel Act that preclude utilities from using gas or oil in new intermediate and base load electric power generation facilities. If this is not possible, we would urge that the Act be modified to permit the utilities to install high efficiency, coal capable, fuel flexible state-of-the-art technology plants, such as the PROGEN concept. This would ensure that all new power plants utilizing natural gas or oil as a fuel will be operated in the most efficient and least costly manner.

We are simply proposing that existing coal-capable, state-of-the-art technology be allowed to provide our future power generation needs. The modular combined-cycle, coal-capable power plant uses proven technology, it can operate on a wide range of fuels, including coal, it is environmentally clean, and it can be installed at much less cost than conventional steam electric power plants. I, therefore, respectfully suggest that, as a DOE study concluded in the late 1970's, use of this technology should be permitted. We believe that the existing prohibitions of the Fuel Use Act inhibits this. The best way to see it occur is to repeal the utility prohibitions portions of the Fuel Use Act or to exclude such equipment from the prohibitions of the Act.

Thank you for the opportunity to meet with you today. I shall be delighted to try to answer any questions that you may have.

Senator NICKLES. Mr. Williamson, thank you very much.

Mr. Cooper.

STATEMENT OF C. WILLIAM COOPER, CHAIRMAN, UNITED DISTRIBUTION COS.

Mr. COOPER. Mr. Chairman, my name is William Cooper. I am chairman of United Distribution Cos., a group of 31 distribution companies rendering gas service in 10 States.

We have submitted to you gentlemen a detailed statement and I would ask that that be put in the record. I would like to make a few comments concerning that.

Senator NICKLES. Certainly.

Mr. COOPER. Our group would support the bills that have been introduced for the modification of the Fuel Use Act and for the elimination of incremental pricing. We fully support those, S. 1251 and S. 2205. We have not come to an agreement, or rather a position on your bill, with regard to the decontrol of old gas.

We are presently considering that, but we have been unable that opinion. My belief is that a majority of our group would oppose that bill because it would increase prices in our opinion without doing anything about the present problem contracts.

We asked to appear today because of our concern about the administration bill. We are strongly opposed to that, both as to the access provisions, as drawn in that bill, and as to the decontrol provisions.

We opposed the access provisions in the last Congress because we were concerned that there would be a depreciation of pipeline service to distribution utilities on the terms of that proposal. We feel strongly, in the same fashion, about the proposal that has been laid before you by the administration.

It calls for the fullest use of pipeline capacity, putting the burden on the pipelines to prove that they do have capacity. We feel that that will undoubtedly lead to an over commitment of pipeline capacity and to a depreciation of service to utilities. We favor the use of excess capacity for transportation. We don't have any problem with using that on a nondiscriminatory basis, but we oppose the type of legislation that is here presented for the reason that I mentioned.

We are very much opposed to the decontrol provisions as presented by the administration because they will tend to increase the prices for old gas without doing anything about the problem contracts that are out there that are firm contracts and that Mr. Lawrence and Mr. McGrath discussed earlier. You cannot raise the prices of old gas through decontrol and only treat one side of the problem. There are two sides of the problems and they arose as a result of the policies of this Government and you can't undo one side of the problem without dealing with the other.

So, we strongly oppose the decontrol provisions as presented by the administration bill. We go into these matters in detail in our statement, and I will respectfully refer you to that.

[The prepared statement of Mr. Cooper follows:]

STATEMENT OF
C. WILLIAM COOPER, CHAIRMAN
UNITED DISTRIBUTION COMPANIES

BEFORE THE SUBCOMMITTEE ON ENERGY REGULATION AND CONSERVATION OF THE SENATE COMMITTEE ON ENERGY AND NATURAL RESOURCES

HEARING ON NATURAL GAS
APRIL 15, 1986

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Mr. Chairman and Members of the Committee:

I appear today on behalf of United Distribution Companies to express our deep opposition to the Administration's proposed Natural Gas Transportation and Regulatory Reform Act of 1986, which was forwarded to Congress last week.

UDC appreciates this opportunity to appear on such short notice. We hastily prepared and submitted this statement, because we understand that this may be the only hearing which your Subcommittee will hold on the subject. We sincerely hope that this will not be the case. The Administration's proposal, in our view, will cause substantial harm to the general public dependent on gas utility service and therefore deserves thorough examination.

IDENTIFICATION AND INTEREST OF UNITED DISTRIBUTION COMPANIES

United Distribution Companies ("UDC") is an *ad hoc* group of 31 local distribution companies rendering more than 20 percent of all natural gas utility service throughout the United States.

The members of the Group are listed on Attachment 1 to this statement. Our members render service in the following 10 states:

Illinois
Indiana
Michigan
Missouri
New Jersey
New York
Ohio
Pennsylvania
West Virginia
Wisconsin

UDC was formed in 1969 for the purpose of ensuring adequate supplies of natural gas at reasonable prices. To this end, UDC has participated in numerous regulatory proceedings before the Federal Power Commission, the Federal Energy Regulatory Commission and other Federal agencies. During the last two Congresses, UDC has actively participated in the legislative processes involving natural gas legislation and considered by the House and Senate Energy Committees. UDC also has fully participated in the administrative processes leading up to FERC's Order No. 436 and is currently appealing that Order on various grounds. More recently, we had the honor of appearing before your Committee at hearings held in October, 1985 with regard to Order No. 436 and other problems affecting the natural gas industry.

UDC is now participating in FERC's proceeding in Docket No. RM86-3-000 with regard to the Department of Energy's proposal to establish new ceiling prices and other proposals for old gas. UDC vigorously opposes that proposal on both legal and economic grounds.

UDC'S CONCERNS REGARDING THE ADMINISTRATION BILL

A. SUMMARY OF UDC POSITION.

1. Open Access Carriage -- Section 102.

This Section provides (1) that, upon request of any person, the Commission shall direct a pipeline to provide transportation service unless the pipeline demonstrates to the Commission that it is incapable of rendering the service; and, (2) that such transportation service shall be provided without discrimination.

UDC has consistently supported voluntary pipeline transportation using excess capacity which is not being used to meet outstanding certificated commitments to distribution companies for utility service to the public. In our view, utility service, in most instances, has economically benefitted by the use of excess capacity for such purposes.

However, UDC opposes mandated carriage in the form stated above, as we opposed similar principles embodied in the proposal considered by the Senate Energy Committee during the last Congress. We do so because such a statutory mandate will inevitably lead to an over-commitment and overloading of pipeline capacity with consequent depreciation of pipeline service to utilities that are required to serve the general public.

If carriage is to be mandated, (and we sincerely believe that Congress should not impose such a mandate), an absolute priority must be provided in favor of all certificated pipeline commitments to local distribution companies for service to residential and other customers.

2. Removal of Wellhead Price Controls - Section 201.

The Administration bill proposes (1) that, beginning April 1, 1987, the field price controls imposed by the NGPA shall cease to apply to the first sale of any natural gas; and, (2) that, in the intervening period, price controls shall cease to apply to any natural gas covered by new or renegotiated contracts.

UDC vigorously opposes this fundamental change in the NGPA pricing policy because of the contractual obligations by which interstate pipelines are now bound. Removal of NGPA price controls would inevitably result in major increases in pipeline average gas costs and rates, with consequent increases in the costs borne by distribution utility service and their residential customers. Considering the market disorders already plaguing existing pipeline rates, these additional pricing problems would be catastrophic. Attempts by the Department of Energy ("DOE") to show that these increases would not occur are completely unfounded.

Furthermore, there is no basis for DOE's claim that the incremental old gas production which would result from the removal of controls would be low in cost. The reality of the situation is that the public would be forced to pay materially higher prices for all old gas in order to achieve relatively small increments in reserves, thus causing the marginal cost of these increments to be excessive.

B. MANDATED CARRIAGE IN THE MANNER PROPOSED WILL IMPAIR PIPELINE SERVICES TO UTILITIES FOR THE BENEFIT OF THE PUBLIC.

In operations under the Natural Gas Act over the years, pipeline capacity to render committed services to utilities has always been adequate and aside from problems due to supply shortages during the 1970's, delivery service has been excellent. This result has been achieved largely because new services were normally undertaken only through voluntary action by the pipelines after detailed proof in certificate processes before the Commission that the pipeline could in fact render the service proposed. Any concerns expressed by existing customers were uniformly aired. When found necessary, facilities or proposed services were adjusted. By the time the certificate process had been completed, it was clear that both existing and proposed new services could be rendered on an assured basis.

The consequent benefits to utility service and the public have been of great significance. Utilities have had an assured delivery base from which to plan their own operations and supplies. Except for emergencies due to physical accident or breakage, they could count on pipeline deliveries.

Mandatory carriage as here proposed would place this situation in serious jeopardy. Demands far in excess of available spare capacity would undoubtedly be presented; all new services would have to be rendered without any discrimination; and, the services so demanded would have to be rendered unless the pipeline demonstrated that it would be unable to do so.

Now, as stated in DOE's explanation of the proposed Bill, it is the specific intention of the Administration that the Commission shall ensure that capacity would be used to its absolute maximum. It is emphasized that: "The primary concern of the Commission . . . must be to ensure competition in the marketplace through utilization of pipeline capacity to the fullest extent practicable." Thus, the care and caution with which prior services were authorized would be abandoned.

This is the same administrative attitude with which NASA became infected in its apparent disregard of its own safety procedures for the sake of expediency in the operation of the space shuttle. With this philosophy infecting the administrative process and the undoubted hesitancy of competing pipelines to prove that they cannot in fact undertake requested services, it is only a matter of time before pipeline capacity would be over-committed and overloaded. Furthermore, with absolutely no remaining safety factor in the lines, the pipelines would be materially hampered in case of operating emergencies. It would be like an airline that was ordered to load the planes far beyond normal design tolerances.

With this mandatory principle being so pointedly expressed, there is no question but that those users of transportation who would come upon the pipeline system through this statutory process would demand equal treatment with those carefully certificated services to distribution utilties for the benefit of the public. Yet, it is bad public policy to cause utility services to the public to suffer impairment in favor of new services brought on the system through this "devil may care" attitude toward sound and assured operations.

UDC believes that transportation should not be mandated on any terms, because we believe that assured delivery conditions on a pipeline are of critical importance and that these are best preserved through voluntary pipeline undertakings. But if transportation is to be mandated, then the bill must provide an absolute service priority for certificated services to utilities for the benefit of the public, in the event either of over-commitment or emergency.

C. THE REMOVAL OF WELLHEAD PRICE CONTROLS WILL NOT DECREASE AVERAGE WELLHEAD PRICES AS ESTIMATED BY DOE BUT WILL ACTUALLY INCREASE THEM.

In submitting the Administration's bill to Congress, the Department of Energy states as follows:

> - After partial decontrol, average wellhead prices declined by about 5 percent in real terms during 1985. Under full decontrol, average prices are projected to fall by about 14 to 17 percent in the first year after enactment, or by about $0.25 to $0.45 per Mcf."

* * * * * * * * * * * * *

> - "Increased production of old gas reserves will lower gas prices and encourage renegotiation of contracts that hold high-cost gas prices above market-clearing levels."

These statements, together with the contemporaneous explanations presented by DOE in support of its decontrol proposal now pending at the Federal Energy Regulatory Commission in Docket RM86-3, are based on the following theses:

(1) that increased prices for old gas following deregulation will bring increased quantities of old gas into the market;

(2) that the competition offered by these additional quantities of old gas will cause producers of higher priced new gas to lower the prices to which they are entitled under existing supply contracts; and

(3) that, in consequence, average pipeline costs of gas will be materially reduced.

In evaluating these claims, the Congress must first recognize that they relate only to pipeline general system supplies used in rendering established sales services to distribution utilities and direct industrial customers, -- as distinguished from direct field purchases by distribution utilities and end-users out of the new spot market. These general system supplies are essentially composed of two classes of field supplies: old gas purchased under long-term contracts entered into prior to NGPA; and new gas purchased at considerably higher cost under contracts entered into since the passage of NGPA. The counterclaim of DOE is that by increasing the prices under the old gas contracts, the prices for new gas will come down and the average pipeline cost will be reduced.

The key assumption of this new DOE proposal is that producers of new gas will voluntarily renegotiate their contracts to provide for a lower price. During the last Congress, both the Administration and the Senate Committee on Energy recognized that, if old gas was to be deregulated and raised in price, then Congress had to take affirmative action to decrease prices for new gas. In other words, it was plainly recognized that, since the two classes of gas work together to achieve an average cost of general system supply, Congress could deal with problems as to one class only by recognizing and dealing appropriately with problems occasioned by the other class.

In this new DOE bill, the Administration deals with only one side of the coin. It proposes a change in policy which will increase prices for old gas, but refuses to deal with the fact that prices for new gas are required by outstanding contracts. DOE merely states that increased competition from additional old gas will automatically induce or persuade producers to bring down these prices.

Producers who hold these firm pipeline contracts for new gas at high prices have refused thus far to renegotiate those prices to lower levels. In the face of this situation, it is irresponsible for DOE to assert to Congress that producers will immediately bring their prices so far down that there will be a

"14 to 17 percent" decrease in pipeline average costs in the 12 months following enactment. This means that producers of new gas must cut their prices enough to keep pipeline average costs at then-current levels. It also means that producers of new gas must bring their prices so far down that pipeline average costs would be reduced and consumers would receive a material reduction in rates.

These assertions defy both sound economics and common sense. Producers of new gas will price their gas at whatever level the market will bear. They may renegotiate their contracts or they may not. To blithely say that they will bring their prices down in the fashion which DOE says that they will is asking Congress to "whistle by the grave yard" in deregulating old gas.

Much is made by DOE of the fact that no "fly up" occurred following partial decontrol on January 1, 1985 and that average prices declined during that year. DOE contends that the reduction of prices which occurred following partial decontrol proves that prices will decline again if this second round of decontrol occurs. However, the supply and operating circumstances of pipelines were far different in January, 1985 than they now are. In 1984 and 1985, pipelines were still able to assert "market out" and other contractual rights for the reduction of prices for new gas. They were able to alter the mix of their supplies to take less high-cost new gas and more old gas;

they were able to renegotiate many of their contracts for high cost new gas. All those steps were taken as a result of intense market reactions and growing gas-for-gas competition between pipelines. In the face of this competition, it appears that pipelines have come about as far as they can down the cost-reduction route without governmental assistance. Yet now, the Administration proposes a tremendous increase in the costs of old gas which could only be accommodated by a tremendous roll-back in prices for new gas. The kinds of price reductions that occurred in 1984 and 1985 are minuscule compared to the reductions the Administration now expects.

If old gas is to be deregulated and consumers are to receive a price reduction, then Congress must deal affirmatively with prices for new gas and make provision by which they shall be rolled back.

Furthermore, it is obvious that rolling-back prices for new gas in order to finance higher prices for old gas presents a serious question of National policy. In the Natural Gas Policy Act of 1978, Congress determined this issue in favor of new gas prices in order to enhance exploration and development of additional reserves. The question was debated at length in Committee processes during the last Congress. It is now wholly ignored by the Administration.

THE NICKLES BILL - S-1302

UDC has considered the various drafts of legislation which have preceded the development of the Administration bill. However, UDC has not had the opportunity to fully consider S. 1302, the Nickles bill and, therefore, we cannot take a definitive position on that bill. We are now in the process of reviewing the provisions of the Nickles' proposal. I might add that since the bill calls for the partial decontrol of old gas, it would have some cost implications. It is my personal opinion, therefore, that a large majority of the UDC Members would oppose the bill. We would, however, be happy to provide more detailed comments on this proposal for the record.

THE DOMENICI-JOHNSTON BILL - S-1251

UDC enthusiastically supports this bill for relief from the onerous provisions of the Fuel Use Act and the incremental pricing sections of the NGPA.

Again, I wish to express UDC's appreciation for this opportunity to appear, and express our views on these legislative measures. For your information, we have attached a copy of UDC's reply comments filed in Federal Energy Regulatory Commission Docket No. RM86-3-000, the DOE old gas pricing proposal.

C. William Cooper, Chairman
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Dated: April 14, 1986

APPENDIX A

Members of United Distribution Companies

Company	State of Operation	Principal City Served
BATTLE CREEK GAS COMPANY	Michigan	Battle Creek
CENTRAL ILLINOIS LIGHT CO.	Illinois	Peoria
CENTRAL ILLINOIS PUBLIC SERVICE COMPANY	Illinois	Quincy
CITIZENS GAS & COKE UTILITY	Indiana	Indianapolis
CITIZENS GAS FUEL COMPANY	Michigan	Adrian
CONSUMERS POWER COMPANY	Michigan	Jackson
THE DAYTON POWER AND LIGHT COMPANY	Ohio	Dayton
THE EAST OHIO GAS COMPANY	Ohio	Cleveland
EQUITABLE GAS COMPANY	Pennsylvania	Pittsburgh
HOPE GAS, Inc.	West Virginia	Clarksburg
ILLINOIS POWER COMPANY	Illinois	Decatur
INDIANA GAS COMPANY	Indiana	Muncie
KOKOMO GAS AND FUEL COMPANY	Indiana	Kokomo
MICHIGAN GAS UTILITIES COMPANY	Michigan	Monroe
NATIONAL FUEL GAS DISTRIBUTION CORPORATION	New York and Pennsylvania	Buffalo and Erie
NIAGARA MOHAWK POWER CORPORATION	New York	Syracuse
NORTH SHORE GAS COMPANY	Illinois	Waukegan
OHIO GAS COMPANY	Ohio	Bryan
ORANGE & ROCKLAND UTILITIES, INC.	New York and New Jersey	Spring Valley
THE PEOPLES GAS LIGHT AND COKE CO.	Illinois	Chicago
THE PEOPLES NATURAL GAS COMPANY	Pennsylvania	Pittsburgh
RICHMOND GAS CORPORATION	Indiana	Richmond
THE RIVER GAS COMPANY	Ohio	Marietta
ROCHESTER GAS AND ELECTRIC CO.	New York	Rochester

SOUTHEASTERN MICHIGAN GAS COMPANY	Michigan	Port Huron
UNION ELECTRIC COMPANY	Missouri and Illinois	Jefferson City Alton
WEST OHIO GAS COMPANY	Ohio	Lima
WISCONSIN FUEL AND LIGHT COMPANY	Wisconsin	Manitowoc
WISCONSIN GAS COMPANY	Wisconsin	Milwaukee
WISCONSIN NATURAL GAS COMPANY	Wisconsin	Racine
WISCONSIN SOUTHERN GAS COMPANY	Wisconsin	Lake Geneva

Senator NICKLES. Mr. Cooper, thank you very much for your comments.

Mr. Ellig.

STATEMENT OF JEROME R. ELLIG, STAFF ECONOMIST, CITIZENS FOR A SOUND ECONOMY

Mr. ELLIG. Thank you, Mr. Chairman. I have a prepared statement for the record, and I will be referring to that in the course of my remarks.

I am here today on behalf of Citizens for a Sound Economy. CSE is in its second year of existence. We are a 250,000-member grassroots citizens organization, dedicated to returning economy decisionmaking to individuals. We are interested in natural gas deregulation because we believe that a free market, unhampered by Government mandated price controls and other forms of interference, is the best guardian of consumer welfare.

CSC agrees with the general approach in the legislation today, but rather than discuss specific bills, I would just like to elaborate our position on a couple of the topic relevant to natural gas deregulation.

First of all, it is our view that price controls on natural gas do not and never did benefit consumers. At best, they benefited some special interests in the short run, at the expense of all consumers in the long run. Those of us in the Midwest and Northeast who shivered through the winter of 1976, because of a Government-created natural gas shortage, suffered so that other interstate users could attain whatever gas was available at below-market price.

I can speak from personal experience in that, at the time I was a resident of the great State of Ohio, ironically enough. Today, a half controlled—half free market prevents all consumers from sharing the benefits of lower prices.

Because new natural gas is not subject to price controls, but old gas is, cheap gas remains in the ground, while producers sell newer, more expensive gas in an uncontrolled market.

According to the Office of Technology Assessment, a total of between 19 and 38 trillion cubic feet of lower priced natural gas will be kept off the market by current policies. The Department of Energy estimates that figure at 8.4 to 11.1 trillion cubic feet, Arco estimates 38 trillion, Shell Oil Co. estimates 42 trillion—whatever the exact number, the results are clear. Wellhead price controls and rolled-in pricing have combined to induce producers to—I will quote here—"To invest real resources worth as much as $8 to $11 per thousand cubic foot in producing gas that has a market value of only about $2.50." That is according to a study published by the American Enterprise Institute.

Proponents of continued regulation predict the gas prices will rise rapidly upon deregulation. Similar predictions have been made in the past and they have always been wrong.

Oil price controls were ended in 1981 and in the ensuing 2 years, crude oil prices fell by 18 percent, gasoline prices fell by almost 10 percent.

Between 1973 and 1984, Federal regulation of natural gas prices was accompanied by a 15-percent average annual increase in residential gas prices. New gas, comprising about half the U.S. supply, was deregulated on January 1, 1985. In the ensuing 12 months, residential gas prices increased by less than one-half of 1 percent, and actually declined in 14 major cities.

Lower oil prices have helped fuel recent gas price declines. Because oil and gas compete in many industrial uses, gas producers have had to lower their prices in order to retain customers. By giving producers an incentive to tap low-cost gas deposits, deregulation would foster competition and reenforce this downward trend in the prices of both fuels.

And to conclude, I would just say that we believe it is time to take the setting of energy prices, including natural gas, out of the political marketplace and put them back in the economic marketplace where they belong.

[The prepared statement of Mr. Ellig follows:]

Testimony of Jerome R. Ellig, Staff Economist
Citizens for A Sound Economy
Before the Senate Committee on Energy and Natural Resources,
Subcommittee on Energy Regulation and Conservation
April 15, 1986

Mr. Chairman and members of the subcomittee, thank you for this opportunity to share Citizens for A Sound Economy's (CSE) views on natural gas deregulation.

My name is Jerome Ellig. I am staff economist at Citizens for A Sound Economy. Now in its second year of operation, CSE is a 250,000-member grassroots citizens organization dedicated to returning economic decisionmaking to individuals. We take a keen interest in natural gas deregulation because we believe that a free market, unhampered by government-mandated price controls and other forms of interference, is the best guardian of consumer welfare.

CSE agrees with the general approach embodied in the legislation under consideration today. Rather than discuss each bill separately, I'd like to elaborate CSE's position on several topics relevant to the natural gas deregulation issue.

Price controls on natural gas do not and never did benefit consumers. At best, they benefitted some special interests in the short run at the expense of all consumers in the long run. Those of us in the Midwest and Northeast who shivered through the winter of 1976 because of a government-created natural gas shortage suffered so that other interstate users could obtain what little gas was available at the below-market price. Today, a half-controlled, half-free market prevents all consumers from sharing the benefits of lower prices.

Because "new" natural gas is not subject to price controls but "old" gas is, cheap gas remains in the ground while producers sell newer, more expensive gas in an uncontrolled market. According to the Office of Technology Assessment, a total of between 19 and 38 trillion cubic feet of lower-priced natural gas will be kept off the market by current policies. The Department of Energy estimates that figure at 8.4 to 11.1 trillion cubic feet. ARCO estimates 38 trillion cubic feet, and Shell Oil Co. estimates a maximum of 52 trillion. Whatever the exact number, the result is clear. Wellhead price controls and "rolled-in pricing" have combined to induce producers to "invest real resources worth as much as $8-11 per thousand cubic foot (MCF) in producing gas that has a market value of only about $2.50," according to a study published by the American Enterprise Institute.

Proponents of continued regulation predict that gas prices will rise rapidly upon deregulation. Similar predictions have been made in the past, and they have always been wrong. Oil price controls, for example, were ended in 1981. In the ensuing two years, crude oil prices fell by 18 percent; gasoline prices fell by almost ten percent.

Between 1973 and 1984, federal regulation of natural gas prices was accompanied by a 15 percent average annual increase in residential gas prices. New gas, comprising about half of the U.S. supply, was deregulated on January 1, 1985. In the ensuing 12 months, residential gas prices increased by less than one-half of one percent--and actually declined in 14 major cities. The average wellhead price of natural gas has fallen from $2.81 per thousand cubic feet (MCF) to $2.52 per MCF. A natural gas analyst for Paine Webber estimates that the wellhead price should fall to $2.29 per MCF this year, a drop of almost nine percent. Other observers have predicted prices below $2.00. The spot market price, meanwhile, has fallen near $1.35 per MCF this year.

Lower oil prices have, of course, helped fuel recent gas price declines. Because oil and gas compete in many industrial uses, gas producers have had to lower their prices in order to retain customers. By giving producers an incentive to tap low-cost gas deposits, deregulation would foster competition and reenforce this downward trend in the prices of both fuels.

Deregulation is complicated by two issues: "take-or-pay" contracts and "common carriage". CSE believes that both issues should be settled through mutual consent of individual pipelines and producers. Congress should neither permit pipelines to break existing contracts nor force them to transport gas against their will. In the long run, consumers will be better served by private compromises than by public compulsion.

There is, however, a crucial area in which Congress needs to act to protect consumers. Since 1938, federal regulation has restricted entry into the gas pipeline industry. Anyone desiring to transport gas across state lines must be "certified" by the Federal Energy Regulatory Commission. In effect, this requirement engages the FERC in a complex process of second-guessing entrepreneurial decisions. The oil pipeline business, on the other hand, operates with no such restrictions on entry.

Congress should act to remove all legal barriers to entry in the gas transportation industry as well.

Finally, there is the issue of altering the 1978 Fuel Use Act to remove a variety of restrictions on gas consumption. In the interests of "conservation", large gas users are prohibited from installing new gas boilers. This policy has encouraged coal use and hence intensified the acid rain problem. Milton Copulos of the Heritage Foundation estimates that permitting industries and utilities in the Midwest to make greater use of natural gas could drastically reduce sulfuric acid emissions, cutting the level of pollution to that which would prevail if they all used No. 2 heating oil. Taxpayers have also been victimized by the 1978 legislation. The Pentagon, for instance, would spend as much as $2 billion to replace gas-fired boilers with coal-fired ones. In a decade of rising deficits and falling energy prices, this is an expenditure which taxpayers can ill afford.

America's energy future is too important to remain a political football. It's time to let consumers reap the full benefits of a free market in natural gas.

Senator NICKLES. Thank you, Mr. Ellig.

Mr. Cooper, I would ask you just a quick question. Mr. Ellig mentioned in his statement the fact that deregulated categories of gas have been falling in price—falling substantially, while the regulated categories have continued to march upward, in spite of the fact that the spot prices and so on are a lot lower. How do you respond to that, when you mentioned that you didn't want to do anything on old gas?

Mr. COOPER. Certainly, old gas deregulation is going to raise the prices of many of the contracts. Now, we don't see how that can be balanced out, because that comes to a very large figure. We don't see how that can be balanced out without doing something to bring down the prices of the high-priced gas. The problem contracts that are of most concern to the industry, in my opinion, are those for new gas and in large measure, that has been decontrolled. The take-or-pay and other provisions of those contracts prevent those prices from dropping. At least, the producers have been unwilling to negotiate those prices down.

And those are the contracts. Now, it has been said many times here this morning, and by the Secretary of Energy, that the experience when there was partial decontrol, that the prices did fall, and Mr. Ellig just mentioned that. That is true, but that related or that fall came because pipelines had market-out and other rights in their possession; they had a chance to change the mix of the supply and take other steps to bring themselves down and meet the market. They don't have the right, now, to negotiate out of those remaining problem contracts.

You cannot raise old gas prices, as they will rise on decontrol, due to contract provisions in those contracts without doing something about those contracts.

Senator NICKLES. Mr. Cooper, have not a lot of those contracts that "were above the market," have not a lot of those been coming down?

Mr. COOPER. Yes, sir, they have.

Senator NICKLES. So you will be familiar with legislation that I am talking about—we didn't talk about doing anything on any side of the equation, except and unless those contracts were voluntarily renegotiated, or they expired, and then we felt like the marketplace would set their prices, and I still think that that——

Mr. COOPER. The marketplace will set the price of those contracts which are renegotiated or which expire and then are made new, yes, sir.

Senator NICKLES. Mr. Williamson, you mentioned your combined cycle units and how difficult it was to get a permit or an exception from the Fuel Use Act, is that correct?

Mr. WILLIAMSON. That is correct, Mr. Chairman.

Senator NICKLES. And did you also say that you had not received one, in the United States, not one had been built since 1981?

Mr. WILLIAMSON. The last one installed in the United States was in 1981.

Senator NICKLES. I am astounded by that. Have applications been made?

Mr. WILLIAMSON. There has not been one purchased for installation because of the uncertainty of the purchasing process. You are talking about a plant that could range from $50 to $250 or even higher—millions of dollars and there are very few utilities that are going to make that kind of a long-term commitment without some front-end protection on the permitting process.

Now, a temporary permit for 5 years, some people say may be a practical approach, but still that is a lot of money that a utility is tying up on behalf of the stockholders, with that short permit cycle being granted.

Senator NICKLES. Most of the permits or exemptions, are they just granted for 5 years?

Mr. WILLIAMSON. For 5 to 10 years.

Senator NICKLES. And you are looking for——

Mr. WILLIAMSON. We are looking at a powerplant that is expected to run for 30 to 40 years. As Mr. Harlow pointed out, that is the depreciation cycle for his plants, and that is the kind of permit time we think only reasonable if you are going to commit to a kind of fuel.

Senator NICKLES. Are exemptions ever granted for 30 years?

Mr. WILLIAMSON. I am not familiar.

Senator NICKLES. I will try and find out, because I could see why investors would be unwilling to put that kind of money up front and then be concerned about maybe losing that.

Mr. WILLIAMSON. Exactly.

Senator NICKLES. Mr. Bagge, a quick comment. You mentioned coal-capable, and we have heard that term. In your statement you indicated some flexibility, I believe, as far as how that would be defined. I don't know that it is defined in your statement. Is it?

Mr. BAGGE. We make no effort—we are talking here, Mr. Chairman, about a principle we think is legitimately a sound element of national energy policy, and however the Congress in its wisdom defines what increment of additional capital costs would be essential to come within that definition, we would abide by. I think another option, it seems to me, would be to place some degree of discretion in the utility PUC's that have the ultimate responsibility for issuing the certificate of public convenience and necessity.

It seems to me you have two options. We are not arguing here, in view of what is going on, that Mr. Harlow should be obliged as a matter of Federal law to expend instead of $600 a kilowatthour for a plant, $1,200. We are are saying that the boiler, at a minimum—we believe that the boiler, and I am no technician, but what I know about the nature of the animal is that if the boiler is coal-capable, it can burn gas, and at a minimum, it would seem to me that the Congress, in looking at this whole problem, would say that based on our previous experience, knowing the vagaries of pricing in this area, that the interest of the consumer and, indeed, the national interests would best be served by some minimal residual policy that would—I say, again, at the risk of being redundant—compensate for the inherent regulatory and policy biases against expending any more money in capital costs to assure the consumers and the utility industries of this Nation flexibility of the fuel choice.

Senator NICKLES. So you are wanting Congress to have in statute a requirement that if a plant would be built, it would have to be built for any fuel, plus——

Mr. BAGGE. Well, the existing provisions of title 2, section 2012, reads simply no new electric powerplant may be constructed without the capability to use coal or any other alternate fuel as a primary energy source. All we are arguing for, and pleading for is that that element of national policy be retained in the future, as you seek to repeal all the other elements of the Fuel Use Act.

Senator NICKLES. Let me make sure we are on the same wave length. You want us to leave that section of the law that does require that if a new powerplant is built, that it would be able to burn coal and then whatever else.

Mr. BAGGE. You could add the term "baseload". I gather there is some sensitivity——

Senator NICKLES. Just a minute. I want to hang in. You want us to have a law that mandates that you have to be able to burn coal and whatever other fuel.

Mr. BAGGE. I am asking you not to repeal the law, Mr. Chairman, that has adopted that as an element of national policy. Now, how you define what the definition of coal-capable is, that is up to the Congress. I would say that I am sensitive to what Mr. Harlow pointed out here, that if you mean that I have to put scrubbers and meet the ever-changing EPA requirements, that are changing on us year by year, to meet sulphur dioxide standards, where now we have indeed another acid rain bill—if I have to build a plant that is capable of meeting every last piece of legislation enacted by the Congress, I would say that is asking probably for too much.

Senator NICKLES. I am glad to hear you say that.

Mr. BAGGE. I am not arguing for that. I mean, if Henry Waxman's bill comes down the pike and we have acid rain legislation, Mr. Harlow's additional costs would be far more than what he said.

Senator NICKLES. Let me ask you another question, and I need to adjourn this hearing. I am late, and probably there are other people, too—then what I hear you saying, and correct me if I am wrong—when you say "coal-capable", you are talking about if a new plant is built, that it would have the availability of the possibility of burning coal but not necessarily designed, built, formulated to where they can be receiving coal. You are not mandating the railroad cars being able to——

Mr. BAGGE. No, I think that would be outrageous. I think what we are talking about is a principle. And the principle is, it seems to me that the infrastructure of this Nation, the new baseload electric utility plants ought to be based on the capability to burn coal. And I don't mean in 24 hours—we have been struggling as a nation to get a mound of coal ever since we were discovered in 1973 in the oil embargo, and we found that we had all this great difficulty in creating an infrastructure, coal-handling capabilities and everything else to shift to coal.

Now coal is no longer sexy, if you will pardon the expression, because of the demise of oil pricing and the consequent effect on gas. All we are saying, is remember, Mr. Congressman, that we are talking about an element of national policy—we should have learned something from what has happened to us in the past. That is all we are saying.

Senator NICKLES. I am going to ask one final question, and I apologize. Mr. Knapp, you mentioned something about world reserves, and I think I heard you say something along the line that we have, what, about 9.5 years of proven reserves. Is that correct? At one time it was 18—am I correct?

Mr. KNAPP. Yes, Mr. Chairman. The United States lower 48 reserves that we have at the end of 1984—the 1985 data are not complete yet—was 9.5 years supply.

Mr. Chairman, I forgot to ask that my testimony be copied in the record. I would do so now.

Senator NICKLES. All of the panelists' statements will be entered in the record, and I appreciate your indulgence and patience throughout this morning here. We will keep the record open for additional questions from other members of the committee, as well.

Thank you, very much.

[Whereupon, at 1:10 p.m, the hearing was adjourned.]

APPENDIXES

APPENDIX I

Responses to Additional Questions

Department of Energy
Washington, DC 20585

May 19, 1986

Honorable Don Nickles
Chairman, Subcommittee on Energy
Regulation and Conservation
Committee on Energy and Natural Resources
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

On April 15, 1986, Secretary Herrington appeared before the Energy and Natural Resources Subcommittee on Energy Regulation and Conservation concerning natural gas deregulation legislation, S. 1302, S. 1251, S. 2205, and S. 2285.

Following that hearing you submitted written questions for our response to supplement the record. Enclosed are the answers to those questions, which have been sent directly to the Committee staff.

If you have any questions, please have your staff call Cathy Hamilton on 252-4277. She will be happy to assist.

Sincerely,

Robert G. Rabben
Assistant General Counsel
for Legislation

Enclosure

POST-HEARING QUESTIONS AND ANSWERS

Relating to the

APRIL 15, 1986, HEARING

Before the

SUBCOMMITTEE ON ENERGY REGULATION AND CONSERVATION
of the
COMMITTEE ON ENERGY AND NATURAL RESOURCES
UNITED STATES SENATE

WITNESS: JOHN S. HERRINGTON
SECRETARY, DEPARTMENT OF ENERGY

QUESTIONS FROM SENATOR NICKLES

Question 1.:	Please show for each year since enactment of the NGPA: A. the amount of gas flowing under each section and under each subsection of the NGPA; and B. the average price of the gas by section and subsection.
Answer:	Comprehensive volume and price data are not available. Information concerning prices and volumes purchased of gas by NGPA section were not collected prior to 1981. Further, these data were not collected by NGPA subsection until recently. Using available data, we have attached a table showing volumes of interstate gas flowing and the average price of gas for each section of the NGPA for the years 1981 to 1985. These partial data are collected from FERC PGA filings and are based on information from 20 to 50 interstate pipelines; it covers only about 80 percent of the interstate market and a small fraction of the intrastate market.

Interstate Volumes and Prices by NGPA Category

(Volumes in Billion Cubic Feet, Prices
in Dollars Per Thousand Cubic Feet)

NGPA Category	1981		1982		1983		1984		1985	
	Volume	Price	Volume	Price	Volume	Price	Volume	Price	Volume	Price
102	1,824	2.97	2,267	3.30	2,496	3.38	2,587	3.84	3,095	3.73
103	936	2.69	1,191	2.95	990	3.10	913	3.26	1,020	3.39
104	5,271	1.22	5,311	1.34	4,146	1.40	3,961	1.46	3,950	1.45
105	46	2.56	48	2.63	52	2.72	53	2.60	61	2.59
106	237	1.00	285	1.08	255	1.09	283	1.15	378	1.17
107	382	6.58	709	7.31	942	6.25	856	5.35	821	4.69
108	156	3.36	222	3.73	160	3.97	189	4.17	217	4.27
109	94	2.27	125	2.48	127	2.48	191	2.58	269	2.79

Source: Energy Information Administration (EIA), Natural Gas Monthly (February, 1986). From FERC PGA filings.

QUESTIONS FROM SENATOR NICKLES

Question 2: Section 102 of the Administration's bill, S. 2285, requires the Commission to direct an interstate pipeline to provide transportation services "without discrimination." The standard currently used by the Commission pursuant to the Natural Gas Act is one of "without undue discrimination." Please provide the Subcommittee with a legal and policy analysis of the use of a "without discrimination" standard as compared to a "without undue discrimination" standard.

Answer: As a matter of policy, DOE decided to use a new standard, "without discrimination", to indicate, in the strongest legislative terms, access to transportation service should be open to all customers. Under the existing standard, "without undue discrimination", pipelines are able to carry gas for some customers but not for others. Even in light of the Maryland People's Counsel cases, which rejected the Commission's blanket certificate rule and special marketing programs as discriminatory, access to available transportation is still not open to all customers. Nor has Order 436 opened up the market. Unfortunately, pipelines continue the practice of picking which customers will receive transportation service. Accordingly, the new section 102 standard is intended to be more stringent than the current standard.

QUESTIONS FROM SENATOR BRADLEY

Question 3: Does DOE intend, by Section 102, that the FERC issue a new order or rule, or simply an order or rule requiring pipelines to transport under Order 436?

Answer: The manner in which section 102 is implemented is left up to the Commission. It can act on a case-by-case basis, or on a generic basis. However, section 102 is not intended to replace Order 436, but rather to complement it. DOE believes it preferable for pipelines to carry gas under a voluntary program, but sees the clear need for a fair alternative that allows producers and end-users the opportunity to obtain transportation. Section 102 is that alternative.

QUESTIONS FROM SENATOR BRADLEY

Question 4: Will the Administration's bill affect Order 436 settlement agreements negotiated by a pipeline and its customers and accepted by the FERC prior to the bill's passage?

Answer: Yes. Section 101 makes clear transportation authorized under NGPA section 311(a) must be available to all customers without discrimination. There is no provision in section 101 to grandfather existing discriminatory practices. Accordingly, to the extent any settlement, including ones already approved, permits a pipeline to carry gas for some customers and not others, the settlement would be in conflict with this requirement.

QUESTIONS FROM SENATOR BRADLEY

Question 5: Under the Administration's proposal, could pipelines adopt transportation agreements outside of Order 436, such as the Texas Gas case approved by the FERC Commissioners (Docket No. CP-86-143-000, 34 FERC Para. 61,203)?

Answer: Yes. The Administration's proposal does not affect the Commission's authority under section 7 of the Natural Gas Act to authorize transportation arrangements. It does give customers the opportunity to obtain transportation where pipelines do not volunteer, either under an Order 436 type program or under section 7, to carry their gas.

QUESTIONS FROM SENATOR BRADLEY

Question 6: What type of a showing under Section 102 would a pipeline have to make in order to demonstrate that "it is incapable of rendering" transportation services?

Answer: The language of section 102 fosters an orientation in favor of carriage. The determination of whether a pipeline is "incapable of rendering" service is a decision for the Commission. In making this determination, the Commission could consider such factors as the actual extent of pipeline utilization, full use of pipeline interconnections, compression, and displacement or other ways of facilitating transportation. The primary concern of the Commission in implementing this provision must be to ensure competition in the marketplace through the utilization of pipeline capacity to the fullest extent.

APPENDIX II

Additional Material Submitted for the Record

AMERICAN COUNCIL ON EDUCATION
Division of Governmental Relations

April 28, 1986

The Honorable Don Nickles
Chairman, Subcommittee on Energy Regulation
  and Conservation
Committee on Energy and Natural Resources
United States Senate
Washington, DC 20510

RE: Deregulation of Natural Gas

Dear Mr. Chairman:

On behalf of the American Council on Education, an association representing the chief executive officers of over 1,400 colleges and universities and the National Association of College and University Business Officers, representing over 2,000 chief financial officers at institutions of higher education, we respectfully request that this statement be included in the hearing record for April 15, 1986, relating to the Subcommittee on Energy Regulation and Conservation's investigation of various proposals concerning the decontrol of natural gas.

The colleges and universities of this country, which expend in excess of $3 billion a year on natural gas, have a significant interest in the deregulation of natural gas. The higher education community supports the legislation pending before the Subcommittee which is designed to promote competition in the natural gas market by providing consumers with nondiscriminatory access to interstate transportation of natural gas. Open access will hopefully generate ample supplies of natural gas at the lowest possible price.

The natural gas market has been plagued by confusion and inefficiency resulting from a complicated 40 year history of federal government regulation. These regulations have engendered a rigid and inflexible market, unresponsive to the forces of supply and demand. It has failed to enable producers, pipelines and distributors to adjust to changing market conditions. The higher education community is concerned that the price and supply of natural gas could suffer further distortion unless major changes are made.

One Dupont Circle, Washington, D.C. 20036-1193 (202) 939-9355

As of January 1, 1985, wellhead price controls were removed from about fifty percent of domestic natural gas supplies. Partial decontrols have not led to price "fly ups", as many predicted, but have instead decreased natural gas prices, increased competition and introduced greater market flexibility.

The colleges and universities are principally concerned with the sections providing for open and nondiscriminatory access to natural gas and its delivery. The open access carriage provisions are intended to open the transportation system to competition. It is hoped that as a result, all gas supplies, including low-cost gas now shut in would become available at prices that reflect the highly competitive market.

Proposals to authorize the Federal Energy Regulatory Commission (FERC) to permit any pipeline to transport gas on behalf of any person, would enable colleges and universities to negotiate directly with the producer for the delivery of natural gas. This provision would be of substantial benefit to the more than sixty percent of colleges and universities that are principally reliant on natural gas as a primary fuel. The right to purchase directly from the wellhead will increase competition between the producer and the pipeline and should ensure the lowest cost gas supply for the consumer.

The purpose of the open access provisions is to eliminate the monopoly that pipelines have had over the sale of gas and to allow customers to choose among pipelines or to purchase gas directly from the many producers or independent marketing companies. The Administration's proposal may however, be deficient in terms of its dealings with residential, college and university and other nonprofit users. On the face of it, it would create a greater access for those large users who have the ability to switch from one fuel to another on relatively short notice ("interruptible" users) while withholding access to the competitive marketplace for others until 1990.

Colleges and universities for the most part are "firm" users of natural gas. That is, the college and university community has no alternative to gas and requires reliable and non-interruptible delivery. FERC Order 436 provides for immediate nondiscriminatory access to interruptible transportation services for gas purchased from certain users, but allows the participating pipelines to retain their monopoly over sales to residential and college and university markets by phasing in a new requirement of firm transportation services over a five-year period. There seems to be no justification for this phase-in of nondiscriminatory access for entities that require non-interruptible service. The effective date for nondiscriminatory access and delivery of natural gas should be uniform for all consumers.

In addition, it has been the intent, expressed in the Natural Gas Policy Act and in the initial regulatory framework, to give high priority treatment to schools, colleges and hospitals for their use of natural gas. Through a series of court decisions and administrative interpretations, this preferred position granted the nonprofit community has been eroded. We respectfully request that the Congress restate its intent that the preferential treatment granted to these users of natural gas be restored.

The higher education community is also interested in the repeal of several sections of the Fuel Use Act of 1978. Principally, we support provisions which would repeal that section of the Fuel Use Act which authorizes the Secretary of Energy to prohibit the use of natural gas or petroleum as a primary energy source where coal or alternative fuel capability exists in major fuel-burning installations. The repeal of this and other demand restraints will allow all customers including colleges and universities to choose the least costly fuel available.

We recognize that natural gas in comparison to coal, nuclear, oil, and geothermal energy sources, is the least polluting of all available energy sources. Certainly it is in the public interest to encourage the use of low-cost natural gas in pursuit of a better environment.

The higher education community supports a comprehensive approach to natural gas policy embraced in the bills being considered before your Subcommittee and supports natural gas legislation that will promote a sound energy policy that will benefit the national interest.

Sincerely,

Sheldon Elliot Steinbach

Sheldon Elliot Steinbach
General Counsel

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Burlington, Vermont

April 25, 1986

The Honorable Don Nickles
Chairman
Subcommittee on Energy Regulation
and Conservation
Committee on Energy and Natural
Resources
SH-212 Hart Senate Office Building
Washington, D.C. 20510

ATTN: Howard Useem

Dear Senator Nickles:

The American Public Power Association requests the Subcommittee's consideration of the following concerns in conjunction with the hearing of April 15, 1986, on S. 1251, S. 1302, S. 2205, and S. 2285.

APPA is the national service organization of more than 1,750 local public power systems in 49 states, Puerto Rico, the Virgin Islands, Guam, and American Samoa. Local publicly owned electric utilities serve 13.6 percent of the population of the United States, and generate 9.6 percent of the nation's electrical energy. APPA member utilities and their consumers are substantially affected by the impediments posed by the Powerplant and Industrial Fuel Use Act to the use of natural gas for electric power production.

APPA strongly supports the repeal of the prohibitions of the Fuel Use Act on the use of natural gas in new electric powerplants and industrial boilers.

Natural gas supply has been abundant virtually since the enactment of the Natural Gas Policy Act of 1978, and supply projections through the end of the century and beyond are positive. FUA's premise that natural gas was a "disappearing" fuel, requiring stringent restrictions on its use, no longer makes sense. It appears that FUA repeal would increase, not diminish, domestic gas supply, by stimulating demand.

FUA's discouragement of efficient technologies such as combined cycle generators is clearly economically counterproductive.

The current national concern about environmental degradation from coal combustion by powerplants and industrial boilers lends urgency to the need to encourage the select use of natural gas in combination with coal in order to cut pollutant emissions. With acid precipitation a major national issue, the environmental benefits of natural gas combustion cannot be ignored. Simultaneous combustion of natural gas and coal or oil is a low-cost method of improving air quality, maintaining jobs for Eastern and Midwestern coal miners, cutting our dependence on imported oil, and maintaining economic growth through economical energy supply.

We are aware that exemptions are granted by the Department of Energy from FUA prohibitions. Such exemptions do not overcome the undoubted and pervasive, but subtle, impact on utility planning of the continued incorporation in national policy of the prohibitions of the Fuel Use Act. In addition, exemptions are both costly and time-consuming. The existence of bureaucratic procedures to overcome disabilities imposed by unwarranted federal restrictions does not justify keeping such restrictions in place.

We appreciate the opportunity to submit these views to the Subcommittee, and urge positive action on legislative proposals now pending to repeal the Fuel Use Act's prohibitions on the use of natural gas in new electric powerplants and industrial boilers. We enclose for the Subcommittee's consideration a policy resolution on FUA repeal adopted by the Legislative and Resolutions Committee of the American Public Power Association in February, 1986.

Sincerely,

Ruth Gonze
Assistant Legislative
Director

RG/sm
enclosure

REPEAL OF FUEL USE ACT PROHIBITIONS ON THE USE OF NATURAL GAS IN NEW ELECTRIC AND INDUSTRIAL FACILITIES

WHEREAS, in 1978, the Powerplant and Industrial Fuel Use Act, Title II of which prohibits new electric powerplants and industrial boilers from using natural gas or oil as a primary fuel source, was enacted on the premise that these fuels were rapidly being depleted and must be preserved for high priority uses, and

WHEREAS, the natural gas supply outlook is positive in both the short and long terms, and

WHEREAS, the prohibitions of FUA discourage the use of highly efficient generating technologies such as gas-fired combined cycle units, even when generation with such technologies is substantially less costly than other available options, thus forcing economic inefficiencies in electricity supply, and

WHEREAS, natural gas is our cleanest burning fossil fuel, and greater use, either alone or in select combination with other fuels, could substantially reduce pollutant emissions, enhancing environmental quality at low cost, and

WHEREAS, U.S. natural gas supply is almost entirely domestically produced, and potential imports would originate from stable neighboring nations; thus, the use of natural gas provides the opportunity to reduce imported petroleum consumption, and

WHEREAS, the premises on which the Fuel Use Act was enacted are no longer valid, and the Act's retention is now contrary to the national interest for the above reasons;

(OVER)

NOW, THEREFORE, BE IT RESOLVED: that the American Public Power Association urges the Congress to repeal Title II of the Powerplant and Industrial Fuel Use Act to permit the use of natural gas in new utility and other industrial facilities.

-- Adopted by the Legislative and Resolutions Committee of the American Public Power Association February 5, 1986, in Washington, D.C.

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